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ECUADOR CONSIDERS CANCELING OCCIDENTAL CONTRACT, REFORMING HYDROCARBONS LAW

The Ecuadoran government has been threatening to cancel a contract with US petroleum corporation Occidental after a ruling in a legal dispute regarding US\$75 million in taxes Ecuador collected from the company went in Occidental's favor. A London-based international arbitration court has said Ecuador improperly collected the money and should return it to Occidental, or Oxy, but Ecuadoran officials said Oxy had not complied with a contract it had signed with the country, and they were looking at rescinding the deal. This comes as Ecuador struggles with a drought-induced emergency in its electrical sector and the president and Congress battle about proposed changes to the nation's laws on hydrocarbons.

Tax-money conflict could crash contract

The Ecuadoran government began investigations into whether Occidental had broken the terms of a contract it had with the state petroleum company Petroecuador. Though there was talk of rescinding the contract, on Sept. 2, the government announced that it would look for a negotiated settlement with the company, as long as Oxy observed national laws.

President Lucio Gutierrez said on local television that, if Occidental "demonstrates that it has not broken the contract, we will obviously be able to find a solution that doesn't affect national interests." The previous month, Attorney General Jose Maria Borja asked Energy and Mines Minister Eduardo Lopez to rescind the contract between Oxy and Petroecuador for the extraction of crude in an Amazonian block. Borja founded his petition on the argument that the US corporation had broken 34 points of the contract, among them its obligation to forewarn the state about the sale of 40% of its rights and obligations in Ecuador to the Canadian company EnCana in 2000.

EnCana is now looking for buyers for its petroleum operations in Ecuador, according to press reports. Its holdings may be worth about US\$500 million, and a potential candidate for purchasing them may be the state-owned Chinese company Petrochina.

Borja said that Occidental had been fined on six occasions for having been out of compliance with production rates authorized by the Direccion Nacional de Hidrocarburos.

The Ecuadoran government announced that it would set up a commission composed of Interior Minister Raul Baca, Economy and Finance Minister Mauricio Yopez, and Lopez to seek a way out of litigation. Yopez replaced Mauricio Pozo, who resigned as finance minister in June (see [NotiSur, 2004-06-11](#)).

President Gutierrez said that Minister Lopez's role as judge in petroleum lawsuits in Ecuador would not prevent him from discussing solutions to the conflict with Oxy.

The dispute regarding the Oxy-Petroecuador contract comes on top of another struggle that has raged between the government and the multinational. Conflict between the two heated up after a decision from an arbitration tribunal in London found that Ecuador had illegally collected US\$75 million in taxes from Occidental over the course of several years. The finding called on the Ecuadoran state to return the money that the Servicio de Rentas Internas (SRI) gathered from the company through the value-added tax (impuesto al valor agregado, IVA). Gutierrez's government has been seeking an alternative way to satisfy the tribunal's June 29 finding and is planning to appeal.

Occidental bases its claim on a law stating that the tax authority should return the IVA to those businesses that export products processed in country. The SRI, however, maintains that the law is not applicable to petroleum companies that extract and export crude oil, without having put it through any prior processing in the country

Occidental says that its operations in Ecuador represent 8% of its worldwide production and contain 4% of the company's proven reserves.

Ecuador hopes US will not include Oxy case in free-trade talks

Media sources say the Ecuadoran government has been under external and internal pressure to resolve the litigation in a way that would favor the company. The pressure comes in part from Washington, along with calls from local business leaders, who are in favor of the immediate return of the sum named by the London tribunal so that the country will project an image of juridical security to foreigner investors.

Foreign Commerce Minister Ivonne Baki has stated her hope that the US will not include the Occidental controversy in the negotiations the two countries are pushing forward for a free-trade agreement (FTA). The Occidental case, she says, "has not been put out as a condition. We hope it won't be presented, but, if it is, we hope the results will be positive for all and there will be a negotiation."

Ecuador, along with Colombia and Peru, has been negotiating an FTA with the US since June (see [NotiSur, 2004-04-02](#)).

Ecuadoran plaintiffs have been suing ChevronTexaco because of contamination of the Amazonian jungle a decade ago (see [NotiSur, 2003-11-07](#) and [NotiSur, 2003-05-23](#)), which has presented another potential stumbling block for free-trade negotiations between the US and Ecuador.

Political struggle regarding IMF-backed petroleum-law reform

The Gutierrez government has been facing struggles in Congress as it tries to broaden private-sector participation in petroleum extraction. Gutierrez has tried to implement a reform recommended by the International Monetary Fund (IMF) that requires changing the Ley de Hidrocarburos.

The reform seeks to introduce a contracting model that would allow businesses to operate jointly with Petroecuador in fields exploited by the state-owned entity. The investors could thereby avoid risk because the reserves are proven. Private businesses can currently associate themselves with Petroecuador as long as the businesses undertake a process of prior exploration, meaning they must risk capital. The Ecuadoran government argues that it lacks resources to invest in Petroecuador fields, which are facing an accelerating decline in daily production. Critics say the state-owned company suffers from a lack of investment, corruption, and bureaucracy.

Gutierrez lost two votes on the hydrocarbon-law reform this summer as the left-leaning opposition and members of his own party, including his wife, voted in a coalition majority against it. Those voting against it argued that it favored private business at the expense of public interest. Yepez said it was not worth going to Washington to ask the IMF for another loan after the legislation failed. The hydrocarbon-law reform is one of ten recommendations that the IMF made to Ecuador to stabilize its economy. In August, Gutierrez said he would be making a third try during the September legislative session.

President Gutierrez declares emergency in electric sector

Facing an energy shortage predicted for this coming October when the annual dry spell begins, President Gutierrez declared a state of emergency in the electrical sector. The decree that Gutierrez signed Aug. 31 will allow the delivery of a US\$15 million subsidy to the sector and will open lines of credit to power-generation businesses to purchase fuel for thermoelectric plants.

The central hydroelectric plant of Paute in the southern Andean region of the country, the largest energy generator in Ecuador, is accustomed to losses during the dry season each year, lasting from October until the beginning of January, which provokes a reduction in electrical-generation capacity. The lack of rains this year in zones where Paute and other plants operate may aggravate the drop-off in generation. With the emergency decree, the government seeks to avoid blackouts later in the year.

The Paute dam fills 65% of the country's energy-consumption needs with 1,000 megawatts of power, which drops to less than a third of its capacity during dry spells. In years past, the decrease in production has led to long periods of energy rationing, causing millions of dollars of losses for industry and annoyance for the entire population.

The government declared an emergency earlier this year in February when Paute's water-flow rate dropped from 151 cubic meters per second to 25.

The government was also looking at proposals on how to reduce power usage by 5%, including proposals on how to reduce residential use by as much as 20%. The decree authorized the Energy Ministry and energy control and distribution organizations to "start a campaign of efficient use and saving" of electricity.

[Sources: The Economist (London), 06/24/04; Bloomberg.com, 08/23/04; El Nuevo Herald (Miami), 08/31/04; Spanish news service EFE, 07/21/04, 08/03/04, 08/09/04, 08/23-24/04, 08/26-27/04, 09/01/04; Notimex, 07/17/04, 07/20/04, 07/26/04, 08/03-04/04, 08/11/04, 08/21-22/04, 08/24/04, 08/27/04, 08/31/04, 09/02-03/04; El Comercio (Ecuador), 09/03/04]