7-20-2007

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U.S. Oil Giants Reject Venezuela's Nationalization Terms; Four Others Accept

by LADB Staff
Category/Department: Venezuela
Published: 2007-07-20

US oil giants ExxonMobil and ConocoPhillips appeared to be ending their operations in Venezuela as the government of President Hugo Chavez negotiated contracts in which the nation would maintain at least a 60% stake in petroleum-development projects along the country's Orinoco Belt (Faja de Orinoco).

Four other major multinationals accepted the government's terms and a major Chinese company expressed an interest in developing projects in the region. The negotiations come as part of Chavez's promise to bring greater national control over Venezuela's most important industry. Venezuela is also South America's largest oil exporter (see NotiSur, 2007-05-18).

ExxonMobil and ConocoPhillips refuse terms

On June 26, the Venezuelan government announced ExxonMobil and ConocoPhillips had failed to meet a deadline on new terms that would have seen Venezuela take majority control. Four other companies BP, Chevron, France's Total, and Norway's Statoil agreed to deals that would see Venezuela holding a 60% to 83% stake in the projects, with state oil company Petroleos de Venezuela SA (PDVSA) taking the central role in production.

Venezuelan Energy Minister Rafael Ramirez said after the negotiations, "To the companies that have taken a stake in our country, a stake in our future, welcome! You can count on support from the Venezuelan government, on the support of our national company Petroleos, to jointly develop the immense businesses and opportunities that we have shaped in our national design for the development of the Orinoco oil belt."

ExxonMobil said it was "disappointed" that it was unable to reach an agreement on the terms of a joint-ownership structure but added that it was in discussions with the Venezuelan government on a way forward. The company reportedly has about US$3.5 billion invested in Venezuela.

In May, PDVSA took over control of exploration projects in the Orinoco Belt, which had been among the last privately run fields in the country. As older fields elsewhere go into decline, development of the Orinoco is seen as key to Venezuela's future production. It is the country's most important oil area, with massive potential. There are proven reserves of at least 80 billion barrels, but there could be enough there to make Venezuela the world's biggest source of oil, holding perhaps as much as 316 billion barrels.

Chavez demanded that private companies hand over majority control to the state as part of a nationalization drive. The six international firms working there had little choice, but there had been intense negotiation regarding compensation. Sticking points in the talks included asset valuation,
compensation for lost value, and rules about decision making in the future joint ventures, industry officials told Reuters news agency.

PDVSA said it now controlled 78% of the Orinoco projects, including full ownership of ConocoPhillips' Petrozuata operation. Before its announcement, news agencies had quoted unnamed ConocoPhillips officials as saying the company had decided to withdraw from Venezuela, effectively pulling out of a US$2.5 billion investment. The head of ExxonMobil, Rex Tillerson, had said that he expected negotiations to continue beyond the June 26 deadline, and it was immediately unclear what the firm would do next.

While Chavez was able to pay cash compensation to nationalize the telecom and energy sectors, analysts suggested that he would not have the funds to pay for a full-scale nationalization of the oil sector. Developing the new fields is vital to Venezuela's plans to double oil output by 2012, as its existing fields in Lake Maracaibo are declining.

The Orinoco projects, the country's largest foreign investment, extract heavy crude from the Faja, a 55,300 sq km (21,400 square mile) patch of tarry oil that rivals Canada's oil sands in size. The projects, which represent a growing share of production for the world's sixth-largest oil exporter, pump oil and upgrade it so it can be more easily shipped and refined. Venezuelan oil output is below its peak of about 3 million barrels per day reached in 2001.

Output averaged 2.34 million bpd in May, according to data compiled by Bloomberg. The Faja del Orinoco accounts for about a quarter of that production, averaging production of 600,000 bpd, according to the government. The Venezuelan government plans to double oil output by 2012 to about 5.8 million bpd.

**Washington and Wall Street disapprove, the world watches**

US Energy Secretary Samuel Bodman said he was "concerned" about the departure of the two companies from Venezuela. "It's not just Venezuela," Bodman said. "We have problems with Nigeria. We have problems with Russia with development of resources." Oil- and gas-producing nations should adopt "laws that will encourage nonindigenous companies to join in the development of those reserves," he said.

Venezuela's bolivar weakened in unregulated trading, and dollar-denominated bonds tumbled after ExxonMobil and ConocoPhillips abandoned operations in the country, raising doubts about future oil output. "This sparks additional anxiety regarding the future of oil investment in Venezuela," said Enrique Alvarez, a Latin America economist at the research firm Ideaglobal in New York. "Investors are going to the dollar as a safe haven."

The bolivar weakened on June 27 to 4,180 per US$1.00 in the unofficial dollar market from 4,050 the day before, traders said. People and businesses turn to the parallel market when they are unable to acquire the limited number of dollars the government sells at the official exchange rate of 2,150 bolivares per US$1.00. The multinational companies' acceptance of the new rules in Venezuela and the potential exit of ConocoPhillips and ExxonMobil point to concern that developments in
Venezuela may influence negotiations over oil and natural-gas projects in other countries, from rising African oil producers like Angola to longtime members of the Organization of the Petroleum Exporting Countries (OPEC) like Iran.

"What happens in Venezuela is something the Russians will look at, and may have bearing on places like Iran, Nigeria, and other countries," said Amy Myers Jaffe, an oil analyst at the James A. Baker III Institute for Public Policy of Rice University.

**China’s Sinopec steps in**

China Petrochemical Corp., the nation's second-largest oil producer, is in talks to drill in Venezuela, where the two US giants pulled out. The company is seeking "heavy oil" projects, said Tong Peixin, a spokesman for unit Sinopec International Petroleum Exploration & Production Corp. China Petrochemical is known as Sinopec Group. China has strengthened links with Venezuela as part of efforts to secure energy supplies for the world's fastest-growing major economy.

The countries signed US$11 billion of energy and transportation accords last August when Chavez visited China. "This shows China is really eager to develop projects in countries like Venezuela, even though there are potential risks, given unstable social conditions," Rachel Tsang, head of oil and gas research at Nomura International (Hong Kong) Ltd., said after the Sinopec announcement. Beijing-based China Petrochemical was among seven foreign oil companies to sign agreements with PDVSA on June 26, the state-owned Shanghai Securities News reported.

Sinopec Group will take 32% of the Posa exploration project in the eastern part of the Gulf of Paria, off Venezuela's northwest coast near Trinidad. PDVSA will own 60%, and Venezuelan construction company Inelectra 8%, the Oil Ministry in Caracas said. Ramirez expects to submit plans for a new joint venture with China to the country's legislature to produce upgraded crude oil instead of orimulsion, using existing agreements between the two countries, the ministry said.

Production of orimulsion, an alternative boiler fuel, stopped Dec. 31 at a venture between PDVSA and China National Petroleum when the government elected to free up heavy oil for more profitable uses. Orimulsion, a replacement for fuel oil to burn in power plants, is derived from the bitumen that occurs naturally in the Orinoco belt. It is changed to a mixture of 70% bitumen and 30% water for transportation by tanker.

China will invest US billion in Venezuela's oil industry, including developing the Junin oilfield, in which China National Petroleum, the country's biggest oil producer, has an interest, Chavez said Aug. 25. Sinopec may cooperate with Venezuela's state petrochemical company Pequiven to build a petrochemical plant in the country, Pequiven President Saul Ameliach said Aug. 23.

**Questions over Venezuela’s ability to profit**

Michael J. Economides, an oil consultant in Houston, said Venezuela could benefit in the short term if fears regarding production translate into higher global oil prices. "If he produces 1% less," Economides said in reference to Chavez, "the world market responds to that and he gets 20% more revenue over a period of time."
But with public spending surging under Chavez and with oil companies from Brazil and India hesitant to make major investments in Venezuela while legal uncertainty persists, energy analysts have cautioned that Venezuela's government risks allowing prized reserves to remain underdeveloped.

"The Venezuelans have increased the cost of developing this resource," said Roger Tissot, director for Latin America at PFC Energy, a consulting firm in Washington. "At the end of the day, the Venezuelan people will pay the price for these decisions."

Other analysts see the potential exit of ExxonMobil and ConocoPhillips as a development opportunity. "Venezuela is now free to find other partners," said Mazhar al-Shereidah, a petroleum economist in Caracas. "I don't think PDVSA can cover all the technical and financial demands of these ventures, but this doesn't constitute a dramatic situation."

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