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## Oil, Gas & Energy Law Intelligence

### **Bolivia's New Contract Terms: Operating Under the Nationalization Regime** **by M.V. Vargas**

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# **BOLIVIA'S NEW CONTRACT TERMS: OPERATING UNDER THE NATIONALIZATION REGIME**

By María Victoria Vargas

On the 27 and 28 of October 2006 all oil companies operating in Bolivia, including Total, BG, BP and Repsol, signed a total of forty four (44) *Contratos de Operación* (“**Operations Contracts**”) abiding by the terms of the nationalization program dictated by President Evo Morales. The Operations Contracts came into effect in May 2, 2007 and today the signatories are going through a cumbersome adaptation process, learning to operate under the new terms and to interact with the re-nationalized *Yacimientos Petrolíferos Fiscales Bolivianos* (“**YPFB**”). The main characteristics and terms of the new Operations Contracts are discussed and analyzed herein.

## **Background: Undoing the Capitalization**

In 1994 under the first government of President Gonzalo Sánchez de Lozada, YPFB was privatized pursuant to the “*Capitalization Law*”<sup>1</sup> and in 1996 a hydrocarbons law<sup>2</sup> (the “**1996 Hydrocarbons Law**”) was enacted allowing private companies to enter into so called “*Risk Sharing Contracts*” for the exploration and production of hydrocarbons. However, effectively the regime was that of a tax/royalty structure where Contractor bore exploration risks and costs, with no actual cost sharing by the Government, and was entitled to own and freely dispose of all hydrocarbon production upon commercial discovery, subject only to paying royalties and taxes.

Under the 1996 Hydrocarbons Law major international oil companies such as Total, BG, BP and Repsol entered the country and investment in hydrocarbons surged. However, growing discontent of the indigenous people feeling disfranchised by successive governments led to popular unrest and in July 18, 2004 a referendum was held where the majority of Bolivian nationals voted in favor of recovering for the State full ownership over the hydrocarbon resources. In 2005 Congress approved a new hydrocarbons law<sup>3</sup> (the “**2005 Hydrocarbons Law**”) which repealed the 1996 Hydrocarbons Law, reclaimed ownership of all hydrocarbons at the well head for the Bolivian State, and set a 180 days deadline for the mandatory conversion of the Risk Sharing Contracts into the new forms of petroleum contracts allowed by the 2005 Hydrocarbons Law. Such new types of petroleum contracts are: (i) production sharing contracts, (ii) Operating Contracts, and (iii) association contracts, and under all three the reserves and production belong to the State and contractor has the obligation to deliver to YPFB the full amount of hydrocarbons produced.

However, it was only when the indigenous leader Evo Morales took office as President of Bolivia that the mandate of the 2005 Hydrocarbons Law became a reality. Having promised its constituency that the hydrocarbon wealth of the country would effectively go back to the people,

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<sup>1</sup> Law No. 1544 of March 21, 1994.

<sup>2</sup> Law No. 2689 of April 30, 1996.

<sup>3</sup> Law No. 3058 of May 17, 2005.

on May 1st, 2006 Morales issued the Supreme Decree No. 28701 nationalizing the hydrocarbon resources of the country (the “**Nationalization Decree**”). The Nationalization Decree also mandated that all companies producing oil and gas in Bolivia had to deliver their entire production exclusively to YPFB, and set a 180 day deadline for companies to convert their operations to the new contracts in compliance with the 2005 Hydrocarbons Law or else YPFB would take over the operation of their fields.

Upon issuance of the Nationalization Decree the government developed the model form of the Operations Contract<sup>4</sup> and the negotiation process began in the midst of legal uncertainty and heightened tension over the actual prospects of investment recovery and of a profitable continuity of hydrocarbon operations in the country. After months of negotiations, on the 27 and 28 of October, 2006 YPFB and all the oil companies operating in Bolivia signed a total of 44 Operations Contracts. Subsequently, as required by the 2005 Hydrocarbons Law, each of the 44 Operations Contracts was individually approved the Bolivian Congress in November 2006 but transcription errors in the laws prevented them from taking effect and required that the bills be resubmitted for approval. The errors were rectified and on April 23, 2007 the Bolivian Congress approved all 44 laws which were then signed into effect by President Evo Morales.

### **The Operations Contract: Characteristics and Main Terms**

The Operations Contract is a sort of service contract between YPFB and one or more oil companies (the “**Contractor**”) whereby Contractor undertakes to conduct petroleum operations in the particular contract area at its sole risk and expense, assuming all costs and providing all required personnel, technology, facilities, materials and capital, in exchange for a compensation consisting of the reimbursement of certain recoverable costs and a profit. YPFB does not assume any risk or liability for the petroleum operations or its results, and Contractor does not acquire any ownership rights over the reserves or the hydrocarbons produced.

The main commercial and fiscal terms of the Operations Contract<sup>5</sup> are the following:

**Contract Term.** The 2005 Hydrocarbons Law allows up to 40 year term contracts; however, the Operations Contract limits the term to 32 years and does not contemplate any extensions, not even as a result of Force Majeure.

**Exploration Period and Work Obligations.** The Exploration Period is divided into phases and their duration is in each case established in an Annex to the Operations Contract. During the Exploration Period Contractor has to carry out a minimum exploration work which is measured in *Unidades de Trabajo de Exploración* (“**UTE**”, Units of Exploration Work). The particular UTEs and their monetary equivalent for each phase of the Exploration Period are set forth in an Annex to the relevant Operations Contract. UTEs performed in a given phase in excess of the minimum can be carried over to the following phase. If Contractor fails to meet the minimum work for reasons not attributable to YPFB or Force Majeure, Contractor has to pay YPFB the monetary equivalent of the unfulfilled UTEs.

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<sup>4</sup> As of this date the only model contract that has been established is that of the Operations Contract. However, President Morales has issued Decree No. 29130 of 2007 authorizing YPFB to form associations with foreign companies to explore for hydrocarbons, in which YPFB must have a minimum 51% participation. Reportedly the first association would be with PDVSA, the Venezuelan national oil company. World Markets Research Limited, Global Insight, May 14, 2007.

<sup>5</sup> Model Operations Contract, YPFB.

**Declaration of Commerciality.** In the event of a Commercial Discovery, Contractor has to submit a Declaration of Commerciality to YPFB, which has 30 days from the date of receipt of the corresponding evaluation report, to approve or reject the commerciality of the discovery.

**Exploitation Period.** Upon approval of the declaration of commerciality of a discovery, Contractor has to prepare the Development Plan and submit it to YPFB for approval, as well as the relevant Work Program and Budget for each year. If Contractor fails to begin performance of an approved Work Program and Budget within 30 days from its approval, YPFB has the right to terminate the Contract with respect to the relevant field.

**Ownership and Control of Hydrocarbon Production.** YPFB has at all times ownership of the production and full control over its commercialization. Contractor is, however, entitled to use the hydrocarbons produced for its own Petroleum Operations free of charge up to the percentages set by the Ministry of Hydrocarbons and Energy (the “**Ministry**”). The hydrocarbons produced, minus the hydrocarbons used in Petroleum Operations (the “**Net Hydrocarbons**”), must be delivered by Contractor to YPFB at the relevant Fiscalization Point where they are measured and certified. YPFB has to notify the Contractor of the destination that YPFB intends for the production and under which commercialization and transportation contracts YPFB will be placing the production. YPFB and Contractor must enter into an Agreement for Delivery of Hydrocarbons, where the terms and conditions for delivery of the production from the field shall be set forth in accordance with the terms of the relevant commercialization contracts. The price for the valuation of the hydrocarbons produced shall be determined in such Agreement on the basis of the terms of the relevant commercialization contracts. If new production requires the opening of new markets or new transportation capacity, Contractor is required to support and provide technical assistance to YPFB in the negotiation of the commercialization and/or transportation contracts.

**Payment of Royalties, Taxes and Charges.** The amounts received by YPFB from the commercialization of the Net Hydrocarbons must be first applied to pay royalties (the Departmental Royalty, the National Compensatory Royalty and the Participation of the General Treasury of the Nation), and to pay the Direct Tax on Hydrocarbons.

(i) Royalties. According to the 2005 Hydrocarbons Law, the Departmental Royalty is payable in favor of the relevant department where the production originates from and is equal to 11% of the hydrocarbons produced therein; the National Compensatory Royalty is payable to the departments of Beni and Pando and it is equal to 1% of the national production; and the Participation to the General Treasury of the Nation is equal to 6% of the national production and is payable to the National Treasury.<sup>6</sup>

(ii) Direct Tax on Hydrocarbons (“**DTH**”). This tax was created by the 2005 Hydrocarbons Law and its rate is 32% of the total production of hydrocarbons. The law further adds that the summation of the total 18% royalties plus the 32% DTH shall in no case be lower than 50% of the total value of the production of hydrocarbons.<sup>7</sup>

YPFB is responsible for paying all royalties and the DTH and must deliver each month to the Contractor the documents evidencing such payments.

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<sup>6</sup> Law 3058 of May 17, 2005 Art. 52.

<sup>7</sup> Law 3058 of May 17, 2005 Art. 55.

In addition, YPFB has to pay the so called “*Patentes*” which are a surface fee payable based on the number of hectares comprising each contract area. The *Patentes* are payable annually in advance, and Contractor must reimburse to YPFB the total amounts paid within 30 days from receipt of the documents evidencing the payment.<sup>8</sup>

***Compensation for Contractor (Retribución del Titular).*** Contractor receives a compensation (“**Contractor’s Compensation**”) from YPFB once commercial production has begun in any of the fields in the Contract Area. Contractor’s Compensation is the only payment made by YPFB to the Contractor for the Petroleum Operations carried out under the Operations Contract, and consists of recoverable costs and a profit.

(i) *Recoverable Costs.* Recoverable costs are all the costs, investments, expenses and obligations of the Petroleum Operations, including those related to exploration operations, evaluation operations, development operations, exploitation operations and abandonment. Such costs incurred by Contractor are subject to approval and audit by YPFB according to the Accounting Procedures attached as an Annex to the Operations Contract. YPFB pays Contractor up to a maximum of 100% of the approved Recoverable Costs.

(ii) *Contractor’s Profit.* The profits resulting from the gross income produced from the sale of Net Hydrocarbons (“**GI**”), minus (a) the royalties, participations, and DTH (“**T**”), and (b) the costs recovered by Contractor in such month (“**CR**”) are shared between YPFB and Contractor pursuant to formulas included in an Annex to the Operations Contract. According to such formulas the profits to be distributed (“**PD**”) are equal to  $GI - T - CR$ . PD is then allocated between YPFB and Contractor; YPFB’s share (“**PDY**”) is determined based on percentages (“**qb**”) set forth in tables attached in an Annex to the contract which vary depending on the production volumes and PDY is equal to  $PD \times qb$ . Lastly, Contractor’s Profit is determined by multiplying PD times the remaining percentage  $((1 - qb) \times PD)$ . Contractor’s Profit is paid on a monthly basis in US Dollars to a bank account indicated by Contractor.

***Guaranties.*** Contractor has to deliver to YPFB a Performance Guaranty and a Bank Guaranty. The Performance Guaranty must be delivered within 20 days from the date of approval of the Operations Contract by Congress. Such Performance Guaranty must be issued by the parent company of each of the companies comprising Contractor, and its form is included as an Annex to the Operations Contract. The Bank Guaranty has to be an irrevocable and unconditional stand-by letter of credit issued in favor of YPFB by a foreign bank with a credit rating of at least A- by Standard & Poors or Fitch, A3 according to Moody’s or an equivalent credit rating by any other international credit rating agency. The Bank Guaranty backs the performance of the UTEs by Contractor. The form of such letter of credit is also included as an Annex to the Contract.

***Assignment and Change of Control.*** Neither party comprising Contractor may assign, encumber or transfer the Operations Contract, either in whole or in part, or any rights or obligations thereunder, except with the prior written consent of YPFB and the Ministry. The contract does not provide that such consent shall not be unreasonably withheld, denied or delayed. No approval is required if the beneficiary is an entity directly or indirectly owned by the Bolivian State. Written approval by YPFB is also required for any voluntary change of

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<sup>8</sup> Law 3058 of May 17 2005, Arts. 47-51.

control of the companies comprising Contractor and failure to comply with this requirement entitles YPF to terminate the Operations Contract without having to pay any compensation to Contractor. In case of hostile or not voluntary change of control, the affected company has to notify YPF within 30 days from its occurrence and YPF can object such change of control for State policy reasons, or if the new controlling company has sued YPF or the Bolivian State before international tribunals. If YPF objects, it is entitled to demand that the interest belonging to the affected company be transferred to a third party within a term of maximum one year and failure to do so entitles YPF to take over the participation of such company without compensation.

**Abandonment.** Contractor is required to have a provision for abandonment operations. The annual amount of the abandonment provision is determined pursuant to formulas set in the contract and once 75% of the reserves of the field have been produced, Contractor has to transfer the funds from the abandonment provision to a trust fund in US Dollars to be exclusively used to cover the costs of the abandonment operations. If any amount remains in the trust once all abandonment costs have been covered, such remainder shall be shared between YPF and Contractor.

**Applicable Law and Arbitration.** The Operations Contracts are governed by the laws of the Republic of Bolivia and disputes that cannot be directly solved between the parties shall be settled by arbitration in La Paz, Bolivia, according to the procedures and the regulations of the International Chamber of Commerce. Technical disputes can be submitted to independent expert determination but the opinion of the independent expert is not binding for the parties.

#### The 44 New Operations Contracts

The new 44 Operations Contracts and their approval laws are listed below<sup>9</sup>. They came into effect on May 2, 2007 and 37 of them are already in production<sup>10</sup>.

Law N°	Company/ies	Contract Area		Law N°	Company/ies	Contract Area
3632	Empresa Petrolera Andina S.A.	Cascabel		3654	Empresa Petrolera Andina S.A.	Grigotá
3633	Empresa Petrolera Andina S.A.	Vibora		3655	Empresa Petrolera Andina S.A.	Boquerón
3634	Empresa Petrolera Andina S.A.	Sirari		3656	Empresa Petrolera Andina S.A.	Palacios
3635	Empresa Petrolera Andina S.A.	Guairuy		3657	Empresa Petrolera Andina S.A.	Puerto Palos
3636	Empresa Petrolera Chaco S.A. y Compañía Petrolera Exploración y Explotación "Petrollex" S.A.	El Dorado		3658	Empresa Petrolera Andina S.A.	Camiri
3637	Empresa Petrolera Andina S.A.	Rio Grande		3659	Empresa Petrolera Andina S.A.	Enconada
3638	Matpetrol S.A. y Compañía Petrolera Orca S.A.	Taterenda		3660	Empresa Petrolera Andina S.A.	Sara Boomerang III

<sup>9</sup> Source: YPF

<sup>10</sup> BNAméricas, Oil and Gas News, June 26, 2007.

Law N°	Company/ies	Contract Area		Law N°	Company/ies	Contract Area
3639	Empresa Petrolera Andina S.A.	Patujú		3661	Empresa Petrolera Andina S.A.	La Peña-Tundy
3640	Empresa Petrolera Andina S.A.	Yapacani		3662	Dong Won Corporation Sucursal Bolivia	Palmar
3641	Empresa Petrolera Andina S.A.	Cobra		3663	Petrobras Bolivia S.A.	Ingre
3642	Respól YPF E&P Bolivia S. A., Compañía Petrolera Exploración y Explotación "Petrolex" S.A., Empresa Petrolera Andina S.A. y Petrobras Bolivia S.A.	Monteagudo		3664	Total E&P Bolivia Sucursal Bolivia y BG Bolivia Corporation Sucursal Bolivia	Tarija Oeste
3643	Petrobras Bolivia S.A., Empresa Petrolera Andina S.A. y Total E&P Bolivia Sucursal Bolivia	San Alberto		3665	Repsol YPF E&P Bolivia S.A., BG Bolivia Corporation Sucursal Bolivia y PAE E&P Bolivia Limited Sucursal Bolivia	Caipipendi
3644	Petrobras Bolivia S.A., Empresa Petrolera Andina S.A. y Total E&P Bolivia Sucursal Bolivia	San Antonio		3666	Petrobras Bolivia S.A.	Irenda
3645	BG Bolivia Corporation Sucursal Bolivia	La Vertiente Los Suris Tarija Este		3667	Pluspetrol Bolivia Corporation S.A.	Yacuiba Rio Seco O'Connor-Huayco San Isidro
3646	Canadian Energy Enterprises CEE Bolivia SRL y Monroy Electrónica y Control "Monelco" SRL	Cascabel		3668	Respól YPF E& P Bolivia S. A.	Tuichi
3647	Vintage Petroleum Boliviana Ltd. Sucursal Bolivia	Naranjillos Porvenir Chaco		3669	Empresa Petrolera Andina S.A.	Amboró-Espejos
3648	Pluspetrol Bolivia Corporation S.A.	Bermejo-Toro-Barredero-Tigre y San Telmo		3670	Empresa Petrolera Andina S.A.	Sara Boomerang I
3649	Petrobras Energía S.A. Sucursal Bolivia	Copal y Caranda		3671	Total E&P Bolivia Sucursal Bolivia y Tecpetrol de Bolivia S.A.	Aquio
3650	Total E&P Bolivia Sucursal Bolivia y Tecpetrol de Bolivia S.A.	Ipati		3672	Petrobras Bolivia S.A. y Total E&P Bolivia Sucursal Bolivia	Rio Hondo
3651	Repsol YPF E&P Bolivia S.A.	Mamoré I		3673	Vintage Petroleum Boliviana Ltd. Sucursal Bolivia y Empresa Petrolera Chaco S.A.	Ñupuco
3652	Repsol YPF E&P Bolivia S.A.	Surubi		3674	Repsol YPF E&P Bolivia S.A., BG Bolivia Corporation Sucursal Bolivia y Empresa Petrolera Chaco S.A.	Charagua

Law N°	Company/ies	Contract Area		Law N°	Company/ies	Contract Area
3653	Repsol YPF E&P Bolivia S.A.	Cambeiti		3675	Empresa Petrolera Chaco S.A.	Chimoré-1 Juan Latino II San Ignacio Los Cusis Vuelta Grande Santa Rosa Santa Rosa W San Roque Palometas NW Bulo Bulo Patujusal Humberto Suárez Roca Los Monos Katari, Junin Chururmas Carrasco, Caigua Montecristo

Contractors are now in the process of submitting their work programs, development and investment plans to YPFB<sup>11</sup> for approval. Reportedly companies are required to invest at least 3.00 billion US Dollars in exploration and production activities<sup>12</sup> and the Ministry expects income from the contracts to reach 2 billion US Dollars, increasing from 1.30 billion US Dollars obtained last year<sup>13</sup>. President Evo Morales has warned the companies that if they fail to meet their investment obligations, the Operations Contracts will be rescinded without compensation. It is yet to be seen whether critically needed investments in exploration, production and infrastructure will be timely made and if the new model actually proves effective to revitalize Bolivia's hydrocarbons sector for the benefit of its people, ironically the poorest of South America<sup>14</sup> while sitting on the second largest natural gas reserve of the region<sup>15</sup>.

<sup>11</sup> El Deber.com.bo, August 14, 2007.

<sup>12</sup> BNAmericas - Oil & Gas News, April 24, 2007.

<sup>13</sup> BNAmericas - Oil & Gas News, May 2, 2007.

<sup>14</sup> 64% of the population of Bolivia is below the poverty line (2004 est.) and there is 7.8% unemployment in urban areas, plus widespread underemployment. CIA, The World Fact book Bolivia (<https://www.cia.gov/library/publications/the-world-factbook/print/bl.html>)

<sup>15</sup> Bolivia has the 2<sup>nd</sup> largest natural gas reserves of South America after Venezuela with reportedly 24.0 Tcf of proven reserves in 2006 according to Oil and Gas Journal (cited by the Energy Information Administration <http://www.eia.doe.gov/emeu/cabs/Bolivia/NaturalGas.html>); but production of natural gas in 2004 was only at 0.4 trillion feet (Energy Information Administration, <http://www.eia.doe.gov/emeu/cabs/Bolivia/Profile.html>) and in 2007 the increment in production has been relatively marginal given the turmoil surrounding the nationalization process.

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