SOUTH AMERICA

Bolivia

SUPREME DECREE NO.28701

President nationalises all aspects of production and sale of hydrocarbons in Bolivia

Bolivia; Energy policy; Foreign investment; Nationalisation; Oil and gas industry; Oil and gas production

On May 1, 2006, the President of Bolivia, Evo Morales Ayma, promulgated Supreme Decree No.28701 to nationalise all aspects of the production and sale of hydrocarbons in Bolivia. On the same date, the Bolivian army took possession of the hydrocarbon facilities in Bolivia.

The Terms of Supreme Decree No.28701 ("the Nationalisation Decree")

Supreme Decree No.28701 consists of a Preamble and nine Articles. The Preamble establishes the political framework of the nationalisation, referring to provisions of the Bolivian Constitution, a national referendum and illegalities in the existing contracts in the oil and gas sector, and asserting Bolivia's sovereign right to its natural resources. The operative provisions of the Nationalisation Decree read as follows:

"Evo Morales Ayma
Constitutional President of the Republic

Considering:

[Preamble]

In the Council of Ministers,

Decrees:

Article 1.- In the exercise of national sovereignty, obeying the mandate of the people of Bolivia expressed in the binding Referendum

value of their production during this transition period (Art.4.I); this 18 per cent is down from 50 per cent under Art.8 of Hydrocarbons Law No.3058 of May 17, 2005 and from the 82 per cent granted under the previous Hydrocarbons Law No.1689 of April 30, 1996; (3) to receive compensation for or continuing participation in their contracts (Art.4.III).

The nationalisation of a controlling percentage of shares in Art.7 affects five Bolivian companies. These companies are presently controlled by foreign investors and, in three cases, include substantial shareholdings by pension funds on behalf of the beneficiaries of the Bolivian Fondo de Capitalización Colectiva. It is understood that the investors and their shareholdings in these companies at the time of the Nationalisation Decree were as follows:

(1) *Chaco SA*: Chaco SA was 50 per cent owned by Pan American Energy (in turn 60 per cent owned by BP (UK) and 40 per cent owned by Bridas Corp registered in the British Virgin Islands). The pension funds BBVA Previsión AFP SA and Futuro Bolivia SA AFP owned 24.5 per cent each, while the remaining 1per cent was owned by individual shareholders.

(2) *Andina SA*: Repsol YPF (Spain) owned 50 per cent of the capital. The pension funds BBVA Previsión AFP SA and Futuro Bolivia SA AFP owned 24.46 per cent each. The remaining 1.08 per cent was owned by individual shareholders.

(3) *Transredes SA*: Royal Dutch Shell (Dutch) and Prisma Energy (United States) each owned 25 per cent of the share capital. BBVA Previsión AFP SA and Futuro Bolivia SA AFP together owned 34 per cent of the share capital. 16 per cent was owned by other shareholders.

(4) *Petrobras Bolivia Refinación SA*: 70 per cent of the share capital was owned by Petrobras (Brazil) and 30 per cent by Pecom (Argentina).

(5) *Compañía Logística de Hidrocarburos de Bolivia SA*: GMP SA (Perú) and Oiltanking GmbH (Germany) each owned 50 per cent of the share capital.

The Nationalisation Decree addresses in Art.6 the future of the Pension Scheme (*Fondo de Capitalización Colectiva*) that depends for income on the returns from shares in Chaco SA, Andina SA and Transredes SA. The shares in these companies were held in pension funds administered by BBVA Previsión AFP SA (owned by Spain's Banco Bilbao Vizcaya Argentaria ("BBVA")) and by Futuro de Bolivia SA AFP (owned by the Swiss Zurich Financial Services Group).[13]

After the transfer of the shares held by the pension funds to YPFB, this state company will hold between 34 and 49 per cent of the shares in Chaco SA, Transredes SA and Andina SA which will reduce the number of shares that need to be nationalised from other investors in these companies to give YPFB the controlling interest required by Art.7. However, it remains uncertain whether the remaining shares will be nationalised on a pro rata basis or some mechanism of selection or discrimination between investors will be applied for the purposes of nationalisation.

Background to the nationalisation, and initial reactions

This Nationalisation Decree is a culmination of a lengthy period of political and legal uncertainty in respect to Bolivia's oil and gas sector. Until 2005 the legal framework of Bolivia's hydrocarbons sector was defined by the Hydrocarbons Law No.1689 of April 30, 1996. This Law was politically controversial, and the contracts entered into with investors had been challenged in the Bolivian courts as unconstitutional.[14] Hydrocarbons Law No.1689 of April 30, 1996 and Bolivian energy policy was the subject of a

[13] The shares in these pension funds were the subject of a further Supreme Decree No.28711 of May 15, 2006, specifically intended to give effect to the Nationalisation Decree. Article 3 of this Supreme Decree No.28711 states that property in the shares in Andina SA, Transredes SA and Chaco SA is recovered, and therefore BBVA Previsión AFP SA. and Futuro Bolivia SA AFP are required to transfer the title to these shares to YPFB. BBVA Previsión AFP SA initially sought an indemnity from Bolivia before surrendering the shares, and it was reported on May 19, 2006 in the Spanish newspaper *El Pais* that BBVA Previsión AFP had decided to challenge Supreme Decree No.28701 before the Constitutional Court of Bolivia on the grounds that it violated the legislation that entrusted it with the management of the Fondo de Capitalización Colectiva in order to secure payment of the BONOSOL.

[14] Supreme Decree No.24806 of August 4, 1997, which approved the model hydrocarbons exploration and development contract was challenged in the Bolivian Constitutional Court on two grounds. First, that the model contract had the effect of transferring property in Bolivia's hydrocarbons deposits to the oil companies, violating Art.139 of the Bolivian Constitution. Secondly, that the model contract had been approved by Decree and executed without being approved by the Legislature as required by cl.5 of Art.59 of the Constitution. The Bolivian Constitutional Court ruled that Supreme Decree No.24806 did not violate Art.139 of the Bolivian Constitution, as the model contract did not transfer the property of the deposits of oil and gas but of the oil and gas production at the wellhead. However, it also stated that the contracts had to be approved by the Legislature (*Sentencia Constitucional del Tribunal Constitucional de Bolivia 00114/2003* of December 5, 2003; and *Sentencia Constitucional del Tribunal Constitucional de Bolivia 0019/2005* of March 7, 2005).

national referendum on July 18, 2004. The five questions (to be answered "yes" or "no") and results of this referendum were as follows[15]:

(1) Do you agree with the repeal of Hydrocarbons Law No.1689 promulgated by Gonzalo Sanchez de Lozada? [86.6 per cent voted "yes" and 13.4 per cent voted "no"];
(2) Do you agree with the recovery of the property of all hydrocarbons at the wellhead by the Bolivian state? [92.2 per cent voted "yes" and 7.8 per cent voted "no"];
(3) Do you agree with the re-establishment of Yacimientos Petrolíferos Fiscales Bolivianos ("YPFB"), recovering state ownership of the shares of Bolivians in the "capitalised" oil companies, in such way as it is able to participate in the entire productive chain of hydrocarbons? [87.3 per cent voted "yes" and 12.7 per cent voted "no"];
(4) Do you agree with President Carlos Mesa's policy of using gas as a strategic resource in order to achieve a useful and sovereign access to the Pacific Ocean? [54.8 per cent voted "yes" and 45.2 per cent voted "no"];
(5) Do you agree that Bolivian exports its gas in the context of a national policy that: guarantees the Bolivian gas consumption; develops the industrialisation of gas within national territory; includes taxes and/or royalties on oil companies up to 50 per cent of the value of oil and gas production for the benefit of the country; and applies the benefits of gas exportation and industrialisation primarily to education, health, roads and employment? [61.7 per cent voted "yes" and 38.3 per cent voted "no"].

As a result of this Referendum Hydrocarbons Law No.1689 of April 30, 1996 was repealed and replaced by Hydrocarbons Law No.3058 by the President of the National Congress, Hormando Vaca Diez, on May 17, 2005. Hydrocarbons Law No.3058 inter alia recovered ownership of all hydrocarbons at wellhead (*boca de pozo*), i.e. at the point of leaving the ground before being separated for refining or transport (Art.5); refounded the state entity YPFB to represent the state in the hydrocarbons sector (Art.6); required all hydrocarbons production to be delivered to YPFB in return for a contractual payment of participation (Art.66); imposed the new IDH tax of 32 per cent on all hydrocarbons production (Arts 53–57); and required parties to contracts executed pursuant to the previous Hydrocarbons Law No.1689 to convert their contracts so as to comply with the new Law within 180 days (subsequently extended until June 2006).

Foreign investors in the energy sector therefore were well prepared for change. There had been reports that certain foreign investors were considering investment arbitration claims after the enactment of Hydrocarbons Law No.3058 of May 17, 2005. Bolivia has signed Bilateral Investment Treaties with various states whose nationals are affected by Hydrocarbons Law No.3058 and the Nationalisation Decree, notably Spain, United Kingdom, United States of America, Germany, France and Argentina, so investment arbitration claims are certainly a possibility. A legal challenge to the Nationalisation Decree before the Bolivian Constitutional Court is another strategy that has been mooted in press reports, and (as noted above) BBVA Previsión AFP SA has already announced a legal challenge to the supplemental Decree relating to the shares held by pension funds. Investors also have a right to compensation for expropriation pursuant to Art.22 of the Bolivian Constitution,[16] although comments by President Evo Morales attacking Bolivian judges as "representing the colonial state" do not encourage confidence in the effectiveness of domestic remedies.[17] There is no Bilateral Investment Treaty between Brazil and Bolivia, but Brazil's state-owned Petrobras reacted to the Nationalisation Decree by immediately suggesting arbitration in New York, presumably on a contractual basis. The Brazilian President, Mr Lula da Silva, subsequently indicated negotiations would take place on a state-to-state basis. As the largest customer of Bolivian natural gas, Petrobras has negotiating strength notwithstanding its lack of any BIT protection.

[15] For a full analysis of the results of the referendum see the website of the Corte Nacional Electoral of Bolivia, and, especially Luis Tapia Mealla, "Por el Sí por el No. Análisis de Resultados del Referendum 2004", available at *www.cne.org.bo*.

[16] Art.22 of the Political Constitution of the Republic of Bolivia reads:

"Article 22.- Guarantee of Private Property

I. Private property is guaranteed, provided that the use made of it is not prejudicial to the collective interest.

II. Expropriation may take place for reasons of public utility or when the property does not perform any social function, in accordance with law and subject to adequate compensation."

There is a limited and antiquated form of Calvo Clause (dating from 1967) in Art.24 of the Bolivian Constitution providing that foreign companies and individuals are subject to Bolivian law, and cannot in any circumstances invoke special treatment nor appeal to diplomatic protection. Article 67 of the Hydrocarbons Law No.3058 also requires a clause waiving the right to diplomatic protection in contracts with YPFB.

[17] *The Economist*, May 20–26, 2006, p.58.

Bolivia needs foreign investment to exploit its hydrocarbon resources, and its Government has indicated it wishes foreign investors to remain. President Evo Morales has told the European Parliament that the Nationalisation Decree "did not expel or expropriate anyone, and that any investor in the country had the right to recover its investment" but added that the foreign investors would be "partners, not owners" in Bolivian natural resources. The foreign investors in the energy sector do not seem to be hurrying to abandon the country, ceasing negotiations or relying on possible legal remedies. The negotiations are complicated by some inflammatory rhetoric by members of the Bolivian Government (which extends to the preamble of the Nationalisation Decree itself[18]). The timing of the Nationalisation Decree associated it first with Hugo Chavez—who has also increased taxes and the state shareholdings in Venezuela's oil companies—and his anti-capitalist rhetoric, and secondly with the state takeover of the interests of Occidental Petroleum in Ecuador on May 15, 2006, and more generally with the spectre of "anti-American leftist nationalism" across Latin America.[19] However, it is dangerous to generalise across Latin America, and the roots of the Nationalisation Decree are in domestic Bolivian politics. The challenge for the foreign investors over the coming months is to negotiate a legally secure and economically viable long-term commitment to the Bolivian energy sector in an unhelpful environment of short-term gesture politics.

[18] The Preamble states that "the people have conquered at the cost of their own blood, the right to their hydrocarbon riches". It describes the existing contracts as violating the Constitution "in delivering the property of our hydrocarbons riches into foreign hands" which is an "act of treachery to the country" and refers to previous "heroic" nationalisations of hydrocarbons in Bolivia in 1937 and 1969.

[19] *The Economist*, fn.13 above, at p.11.

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