

## ENERGY ADVISOR

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## FEATURED Q&amp;A

## Will Pemex's New Oil Finds Reverse Output Declines?



Mexican state oil company Pemex's chief executive, Carlos Treviño, confirmed the discovery of seven reservoirs in two wells in Mexico's southeast basin. // File Photo: Pemex.

**Q** Mexican state-run oil company Pemex announced on Oct. 9 it had discovered oil in the shallow waters of the Gulf of Mexico that could contain as much as 180 million barrels of crude equivalent. The discovery could add as much as 210,000 barrels of oil per day and 350 million cubic feet of gas per day to Pemex's output, which has been declining for 14 years. This would represent about one-third of President-elect Andrés Manuel López Obrador's goal of increasing Pemex's current production by 700 million barrels by the end of his six-year term. What do the new discoveries mean for Mexico's oil and gas sector? Will they be sufficient to reverse the country's production decline? What should Pemex do to ensure it takes full advantage of the discoveries, and how might international players benefit from the new finds?

**A** Steven P. Otilar, partner at White & Case in Houston, and Francisco de Rosenzweig, partner at White & Case in Mexico City and head of the Mexico Office's Energy, Infrastructure, Project and Asset Finance Group: "While media attention has been focused on private companies' exploration success in Mexico, Pemex has also been hard at work trying to develop the resources allocated to it in the 2013 energy reforms. Pemex has announced major discoveries in areas including Ixachi, Mulak and Manich. In addition to the formal farmout process, where Pemex has secured more than \$1 billion in investment commitments, Pemex has been one of the most successful bidders in oil and gas rounds, securing three blocks on its own and 11 more under successful partnerships with foreign oil companies. Adding

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## TOP NEWS

## OIL &amp; GAS

## López Obrador Slams Pemex for Crude Imports

Mexico's president-elect said Pemex's plan to import 1.4 million barrels of light crude oil from U.S. refiner Phillips 66 was a failure of neoliberal economic policies.

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## RENEWABLES

## Enel Constructing Largest Solar Plant in South America

The Italy-based renewable energy company has begun construction of a 475 megawatt solar park in Brazil. The facility is expected to open in 2020.

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## OIL &amp; GAS

## Venezuelan Gov't Shuffles PDVSA Top Posts: Sources

Several sources told Reuters the Venezuelan government has appointed new officials to top management positions at the state oil company. There has been no official announcement. PDVSA's president, Manuel Quevedo, remains in his position.

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Quevedo // File Photo: Venezuelan Government.

## OIL AND GAS NEWS

## López Obrador Blasts Pemex for Importing Crude From the U.S.

Mexican President-elect Andrés Manuel López Obrador on Tuesday slammed Pemex for its plan to import light crude from the United States, *El Financiero* reported. Mexico's state-run oil company earlier this week awarded a tender for Houston-based refiner Phillips 66 to supply Pemex with at least four 350,000-barrel cargoes of light crude from the Bakken Formation from November through December, or a total of 1.4 million barrels. The deal marks the first time in more than a decade that Pemex will import crude. "This announcement ... is another example of the great failure of neoliberal economic policies in the last 30 years," López Obrador, who takes office on



López Obrador // Photo: @lopezobrador\_ via Twitter.

Dec. 1, said on Twitter. The company needs the imports to feed Mexico's main refinery, which is currently operating below capacity due to a lack of light oil, *Reuters* reported. Problems at the Xanab oilfield have prompted Mexico's light crude output to drop faster than expected this year, and Pemex chief executive Carlos Treviño has said he expects the company's production goals will not be met this and next year. The president-elect has previously said he plans to invest roughly 70 billion pesos (\$3.6 million) to reverse a 14-year decline in production and an additional 25 billion pesos (\$1.3 million) to revamp the company's refineries, which are working at 40 percent capacity, *El Financiero* reported. Last week, López Obrador said he

aims for Mexico to stop all fuel imports and instead focus on domestic consumption. One of López Obrador's economic advisors, Abel Hilbert, earlier this month said crude imports could remain the same as a way to increase processing levels at Mexican refineries. "I think Pemex has good reason to do it due to current market conditions," Hilbert told local media, *Reuters* reported. Last week, ratings agency Moody's said cutting oil exports would sacrifice Pemex's cash flow, whose main source of revenue is crude exports, *El Financiero* reported.

## Venezuela's PDVSA Shuffles High-Level Executives: Sources

The Venezuelan government appointed five new high-level executives to state oil company PDVSA last week, according to six unnamed sources, *Reuters* reported Oct. 17. Amid declining production, PDVSA has reportedly shuffled the heads of some of the company's top units, although the government has not officially announced the changes. Venezuela's Information Ministry and the company did not respond to *Reuters*' request for comment last week. The sources said the new executives are relatively unknown in the energy sector and include at least one military official. Miguel Quintana, formerly vice president for planning and engineering at PDVSA, has reportedly replaced Nelson Ferrer as the company's head of exploration and production. Additionally, José Rojas, a National Guard general who previously worked at the country's Defense Ministry and Housing Ministry, will now lead the state oil firm's trade and supply department, according to the sources. PDVSA President Manuel Quevedo, who is also Venezuela's oil minister, will reportedly remain in his position. The company's production has dropped to a six-decade low since Quevedo was appointed late last year. The fall in output has squeezed PDVSA's coffers, prompting it to default on most of its bonds this year, bringing legal trouble for the company. [See related [Q&A](#) on PDVSA's legal issues in the Aug. 24 issue of the *Energy Advisor*.]

## NEWS BRIEFS

## China's State Power Eyes Acquisition of Brazilian Plants

One of China's major electricity generation companies, State Power Investment Corporation, is in talks to buy two hydroelectric dams and thermal plants in Brazil, according to an unnamed source with knowledge of the matter, *Valor Econômico* reported Oct. 18. Reportedly, one of the hydroelectric dams is Brazilian infrastructure group Triunfo Participações e Investimentos' 800 megawatt Usina Três Irmãos in São Paulo State. State Power is also eyeing two of France-based Engie's thermal plants in southern Brazil, the source said.

## Uruguay Among World's Biggest Wind Energy Producers: Report

Uruguay ranks second among the world's wind energy-producing countries, according to a report released last week by Montevideo-based consultancy SEG Ingeniería, *MercoPress* reported Oct. 17. The report, based on U.S. Department of Energy data for last year's wind technologies market, says 40.1 percent of Uruguay's power is wind-generated, the second-highest share behind Denmark.

## Enel Begins Construction of Largest Photovoltaic Plant in South America

Italy-based Enel Group has begun construction of a 475 megawatt solar park in Brazil, *CNBC* reported Tuesday. The renewable energy company said it would invest roughly \$390 million in the project, which it said would be the largest solar plant in South America. The São Gonçalo facility, located in the northeastern state of Piauí, is expected to begin operations in 2020. It will be able to generate roughly 1,200 gigawatt hours per year and prevent the emission of more than 600,000 tons of carbon dioxide, the company said.

## Pipeline Owned by Canada's Gran Tierra Bombed in Colombia

One of Canadian oil company Gran Tierra Energy's pipelines in southern Colombia was bombed on Oct. 19 by an unidentified group, a senior military chief said, Reuters reported. The attack caused a fire and an oil spill at the pipeline, which is used to transport oil from the Costayaco 11 oil well, according to Army General César Augusto Parra. "There was criminal activity against Gran Tierra Energy. A line transporting crude was affected. The fire was extinguished, and we are working to find the

**Oil pipelines are often a target of armed groups in Colombia.**

authors of this act," Parra told the wire service. Dissident members of the former Revolutionary Armed Forces of Colombia, or FARC, guerrillas operate in the region. The Calgary-based company, which produces about 35,400 barrels of oil equivalent per day in its Colombia operations, did not immediately respond to Reuters' request for comment. Oil pipelines in the South American country are often a target of leftist guerrillas and other rebel groups. State-controlled oil company Ecopetrol's Caño Limón pipeline has been attacked roughly 60 times this year alone. [See related [Q&A](#) in the Sept. 7 issue of the Energy Advisor.]

### RENEWABLES NEWS

## Argentina Signs 300 Megawatts in Solar Projects of RenovAr 2

Argentina has signed 300 megawatts in solar power projects that won tenders in round two of its RenovAr renewable energy auction

### FEATURED Q&A / Continued from page 1

to new discoveries and international partnerships, the migration process for existing service contracts is finally proceeding. With all of this upstream activity, much work remains to be done to successfully increase Pemex's production by 700 million barrels in the next six years. Despite changes in tax regulations allowing Pemex to retain more of its revenues to dedicate to exploration and development, Pemex remains obligated to pay a special royalty to the government that significantly limits the impact of such fiscal reforms. Further, finding new partners to help develop upstream assets remains burdensome. Despite complaints of Pemex's inefficiency, according to Wood Mackenzie, Pemex's production costs are around \$10.90 barrel, just ahead of Shell, but below Petrobras, ConocoPhillips and Chevron. Thus, Pemex has the capability and the asset base to reverse the trend of lower production, but it must focus its capital on development of these assets and receive further relief from some of its fiscal obligations to the state. Pemex will not likely be able to attain the lofty goals of reversing decades of lower production alone. While Pemex will be the engine for upstream growth, direct foreign investment through new upstream operators is required for ultimate success. Simple economics dictate that with more operators and more wells being drilled, production declines will reverse and could far surpass the highest levels of historical production. Whether such progress is allowed to continue will depend on the regulators in the energy sector and the desire of the government to facilitate the growth of production for all players in the market."

**A** **Maria Cortez, senior research manager of the Latin America upstream industry at Wood Mackenzie:** "AMLO inherits a maturing asset base and will depend on a backlog of discoveries to achieve his ambitions of raising output. The Manik and Mulach discoveries are positive steps

towards reversing Mexico's declining production. But to take full advantage of new discoveries, a development mindset is needed. For Pemex, the new discoveries must be weighed against existing opportunities. While Pemex could develop these

**A healthy long-term production outlook in Mexico is possible, but it will need the private sector."**

— Maria Cortez

discoveries, it could also seek a joint venture partner to accelerate development. Mexico's private sector and their early projects—like Talos Energy's Zama or Eni's Amoca—have shown that it can move quickly. AMLO and Mexico stand to benefit most by whichever option can appraise and bring production onstream quickly. Longer term, however, these discoveries alone cannot reverse Mexico's declining production. The country's oil production has declined year-on-year since its 3.4 million barrels per day (bpd) peak in 2004 to just 1.85 million bpd as of this year's third quarter. This is despite high levels of spending, particularly between 2009 and 2014. The discovery and development of more technically challenging resources in offshore areas is higher risk, but also higher reward in terms of the potential volumes. The seismic acquired prior to the recent bid rounds should enable Pemex to identify drilling opportunities away from its existing super-giant fields in the Campeche sub-basin. A diverse corporate landscape now exists in Mexico's upstream sector. International oil companies bring expertise, technology and capital, which will be needed where Pemex has limited experience—such as subsalt clastics, deepwater and HP/HT (high pressure, high temperature wells). A healthy long-term production outlook in Mexico is possible, but it will need the private sector."

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program, Renewables Now reported Tuesday. Shareholders of the La Pirka, Ullum X and Verano Capital Solar One photovoltaic projects, each with an installed capacity of 100 megawatts, signed power-purchase agreements with officials from Argentina's electric market management company CAMMESA, developer Verano Capital announced last week. The latest deals bring the number of signed contracts in the second RenovAr round to 68 projects, equivalent to 1,608 megawatts, PV Magazine reported. Twenty other public contracts won in the program's second round of tenders are expected to close by the end of the year. [Editor's note: See related [Q&A](#) on Argentina's renewable energy goals in the Oct. 12 issue of the Energy Advisor.]

## POLITICAL NEWS

### U.S. on Path of Confrontation: Cuba's Rodríguez

The United States is on a path of "confrontation" with Cuba and is pressuring countries to reject Cuba's annual United Nations resolution, planned for next week, calling for an end to the U.S. embargo of the island, Cuban Foreign Minister Bruno Rodríguez told reporters Wednesday, El Nuevo Día reported. Since Donald Trump became U.S. president last year, relations between the two countries have deteriorated with tighter U.S. travel and trade restrictions. The straining of relations followed former President Barack Obama's moves to thaw diplomatic relations including the opening of embassies in Washington and Havana. During the hour-and-a-half news conference in Havana, Rodríguez decried the Trump administration's tougher stance. "We regret the U.S. government is advancing on a course of confrontation with Cuba," he said, Reuters reported. Last week, a White House official said the administration was planning to increase economic pressure on Cuba's intelligence agency and military, as well as on Venezuela's government, the wire service reported. In his remarks Wednesday to reporters, Rodríguez also said the United

## ADVISOR Q&A

### What's the Outlook for Copper Prices & Chile's Economy?

**Q** The value of Chile's copper exports fell 17 percent in September, compared to the same month last year, amid price volatility surrounding the metal, the South American country's top export product. Meantime, President Sebastián Piñera announced an expenditure increase of just 3.2 percent in next year's budget, the lowest level of public spending expansion in eight years, several months after his mining minister said a rebound in copper prices was "essential" for implementation of Piñera's government plans. What is the outlook for global copper prices in the near future, and how may this affect Chile's economy in the short and long term? How much do Piñera's proposals, including pension reforms and a student loans fund, rely on revenue from copper output? Does he have plans to diversify the Chilean economy?

**A** Marcos Lima, former executive president of Codelco and partner at CIS Consultores: "Though the sharp drop in exports in September may have been an isolated case, when it's added to a fall in the price of copper of around 10 percent compared to September last year and a decrease in production associated with the long festivities of 'Fiestas Patrias' and other factors, it's clear the future of copper prices depends, fundamentally, on what occurs in the trade war between China and the United States.

In fact, with China accounting for more than 50 percent of global copper demand, it is impossible to avoid the trade war's uncertainty, despite supply and demand and the growth of the global economy showing favorable signs of higher copper prices in the near future. Speculative investment funds, very vulnerable to the trade war's uncertainty, are affecting short-term copper prices. However, we can't forget that Chile's budget calculates fiscal revenue using long-term prices, which an expert panel conservatively estimated would undergo a slight increase. This in turn implies more revenue coming from the copper industry, regardless of what happens to the metal's price over the next year. Nevertheless, expenditures will be financed more by a hike in trend GDP growth than by copper, another variable that influences budget estimates. The biggest concern for the future of the copper industry in Chile has to do with a drop in ore grades and the absence of new mines, which implies more investment without correlating production increases. This will result in no significant increases in tax revenues for the country, except if there is a new boom in copper prices, which is not expected at present."

**EDITOR'S NOTE:** More commentary on this topic appears in the [Q&A](#) of the Oct. 22 issue of the Latin America Advisor.

States is trying to win support for its embargo at the United Nations during the General Assembly next week at which Cuba's government is expected to again call for the embargo's end. Rodríguez said the United States seeks to justify the embargo because of human rights concerns, while it "violates the human rights of

the Cuban people." At the United Nations last week, U.S. diplomat Kelley E. Currie attempted to introduce a campaign to highlight Cuba's jailing of dissidents, but Cuba's delegation and its supporters responded by shouting and pounding on their desks, the Miami Herald reported. This week, U.S. Secretary of State Mike

## NEWS BRIEFS

## Bolsonaro Maintains Lead Ahead of Brazil Election

Brazilian far-right presidential candidate Jair Bolsonaro leads the race just days ahead of the runoff vote scheduled for Sunday, Globo reported. The latest Ibope poll, released Tuesday, shows the former army captain with 57 percent support among valid votes, and Fernando Haddad of the Workers' Party with 43 percent support. Bolsonaro saw a two-percentage point drop compared to the previous poll, but the new survey's margin of error is also two percentage points.

## Mexicans to Vote on Whether to Continue Airport's Construction

Over the course of Oct. 25-28, Mexicans will decide whether to continue the construction of Mexico City's new airport, which is already about one-third complete, or update the existing airport in the capital and convert a military base nearby into a commercial hub, the Associated Press reported. President-elect Andrés Manuel López Obrador had previously said he would cancel the \$13 billion project, but later vowed to let the public decide through a national vote. [Editor's note: See related [Q&A](#) on Mexico's new airport in the Oct. 19 issue of the Advisor.]

## Chilean Court Orders Church to Pay Men Allegedly Abused by Priest

Chile's Court of Appeal has ordered the archbishop's office in Santiago to pay a total of \$650,000 to three men who have alleged that they were sexually abused by a priest, Fernando Karadima, La Tercera reported Sunday. A three-judge panel accepted the appeal for "moral damages" against the Catholic Church for covering up the incidents. A lower court previously rejected the case citing a lack of evidence, Reuters reported.

Pompeo called the Cuban delegation's reaction a "childish temper tantrum." On Wednesday, Pompeo told reporters that he had written a letter to U.N. Secretary General António Guterres "requesting to know what measures the U.N. will take to respond to these actions and make sure that they do not happen again." [Editor's note: See [Q&A](#) on Cuban President Miguel Díaz-Canel's recent trip to the United States in the Oct. 12 issue of the Advisor.]

## Eight Colombian Soldiers Arrested in Civilian's Murder

Colombian authorities have arrested eight soldiers in connection to the murder of a civilian earlier this year, El Tiempo reported Wednesday. The soldiers are accused of killing a farmer and wounding a second individual in the northeastern Arauca Department in March, in an incident that was "unrelated to confrontation," prosecutors said, without identifying what



Duque // File Photo: Colombian Government.

prompted the attack, Agence France-Presse reported. The detained men will be charged with "aggravated homicide and attempted aggravated homicide," the prosecutor's office said. For years, Colombia's army has been accused of killing civilians in remote areas of the country and pretending the victims are guerrillas killed in combat, incidents known as "false positives." In its annual report, Human Rights Watch said "the military often abducted victims ... and killed them, placed weapons on their bodies and reported them as enemy combatants killed in action," adding that roughly 3,600 such murders had been investigated by Colombia's prosecutor's office from 2002 to 2008. Dissidents of the former Revolutionary Armed Forces of Colombia, or

FARC, guerrillas, the National Liberation Army, or ELN, rebels and drug trafficking gangs are battling over control of drug routes along the Colombia-Venezuela border near Arauca, AFP reported. Colombian President Iván Duque in August put on hold peace talks with the ELN as the country deals with a record level of coca plant crops, from which cocaine is produced, the U.N. Office on Drugs and Crime said last month. [Editor's note: See related [Q&A](#) in the [Oct. 4](#) and [Oct. 17](#) issues of the daily Advisor.]

## ECONOMIC NEWS

## Argentina Registers First Trade Surplus Since December 2016

Argentina had a trade surplus of \$314 million in September, the country's official statistics agency said on Tuesday. It is the first surplus the South American country has registered in 20 months, since December 2016, but the figure reflects a significant drop in imports after the Argentine peso's value has more than halved against the U.S. dollar so far this year, Perfil reported. Imports in September declined by 21.2 percent, while exports fell just 4.8 percent, compared to a year ago. "The trade surplus in September was the first sign of the expected trade and current account adjustment following the large currency devaluation and sharp slowdown in investment spending," Goldman Sachs economist Alberto Ramos said in a research note, Reuters reported. Economists, including at Argentina's finance ministry, expect the trade surplus trend to continue as a more competitive peso benefits exporters, Los Andes reported. The country has an overall trade deficit of \$6.5 million so far this year, larger than last year's \$5.1 million during the same period. Earlier this year, Argentina suffered a sharp blow to its exports as the worst drought in 60 years hit the agriculture sector, dragging the economy into recession. The Buenos Aires Grains Exchange said in September that it expects favorable weather conditions to help bring record harvests next year, which could also contribute to a continued trade surplus.

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**A** Doris Rodriguez, partner at Hulton Andrews Kurth LLP, and Carlos A. Chávez, senior associate at JATA-J.A. Treviño Abogados: "While discoveries of this scale are clearly impressive and good news for Pemex and Mexico's oil and gas sector, the newly discovered Manik and Mulach fields contain 3P reserves and realistically will require several years to produce and to assess whether this production (measured against Mexico's current production) will meet AMLO's

**“It is estimated that, in two years, the downward trend of national reserves can be reversed.”**

— Carlos Ochoa

goals. Significant investment and advanced technology and know-how will be required to achieve production of these fields, and also of additional hydrocarbon resources in order to meet the goal. Pemex is likely to focus a considerable amount of its efforts, funds and expertise in shallow water production, but will need exploration and development partners in the deepwater plays. Thus, not only will AMLO's projected capital injection into Pemex play a significant role, but additional investment from the international industry sector and varied oilfield services providers' participation will also be required. The ability to achieve AMLO's goals will depend on the level of comfort Mexico provides international players, including, most importantly, investor certainty and transparency in the legal and regulatory schemes and bidding and contracting procedures; availability of recognized and impartial dispute resolution; improved commercial terms, such as pricing and reasonable requirements for any required guarantees; and sharing of liability among all participants."

**A** Carlos Ochoa, partner at Holland & Knight in Mexico City: "Even though we only know what has been outlined in news stories and in press conferences, exploratory efforts have allowed for the reduction of a decline in production in the emblematic Cantarell field and progress to be made in perforation. In August, Pemex's crude production averaged 1,820,000 barrels per day (bpd), far from the 3.4 million bpd average of 2004, a historic maximum. President-elect Andrés Manuel López Obrador, who will take office on Dec. 1, has said his government will raise the country's crude production and that, by the end of his six-year term, output will be around 2.6 million bpd. He has also said, in various venues, that private investments will be allowed to continue, but he did not say under what schemes. Likewise, both Pemex executives and energy authorities, such as the appointed incoming secretary of energy, have recognized that more investment in exploration is required to reverse Mexico's declining crude oil and gas production. It is worth noting that neither Pemex nor any other authority have confirmed there will be a tender in the future for private companies and foreign investors to participate in the activities to come in the newly discovered rigs. Similarly, it has been emphasized that Pemex's operations could start soon to rapidly increase its production, due to the nearby infrastructure that Pemex already has in operation. Provided that the recovery trend on the price per barrels continues, in addition to the current legal framework that allows the participation of private companies in the oil and gas sector, it is estimated that, in two years, the downward trend of national reserves can be reversed. These discoveries confirm the remaining potential of the oil basins in the southeast of Mexico, whose future development, given its proximity to already existing infrastructure, will contribute to Pemex's production goals in coming years."

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