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## FEATURED Q&amp;A

## Are the CFE's Moves Scaring Investors Away From Mexico?



Mexico's Federal Electricity Commission, or CFE, which is headed by Manuel Bartlett Díaz, is renegotiating contracts struck under the previous administration. // File Photo: Mexican Government.

**Q** Mexican national power utility CFE on July 2 said it is seeking \$899 million in a dispute over several pipeline contracts signed under the previous administration with companies including Grupo Carso, TransCanada and IEnova, a subsidiary of U.S.-based Sempra Energy. Both Canada and the United States have blasted the move, with the U.S. Chamber of Commerce saying it sends "a negative signal" about the "business and investment climate in Mexico." Mexican President Andrés Manuel López Obrador has questioned the contracts, suggesting they were too costly for the state. What is the reasoning behind the CFE's claims that the contracts under question are unfair? What implications does the arbitration case have for the power utility and for Mexico's energy sector in general, and to what extent will it affect foreign investment in Mexico? How well is the CFE faring under its new leadership?

**A** Pedro Niembro, senior director at Monarch Global Strategies: "CFE's request for international arbitration to annul several key terms in seven gas pipeline contracts is an attempt to correct what the state-owned utility perceives as an unfair inheritance from the Peña Nieto administration. Under the terms of the contracts, CFE would owe more than \$800 million this year alone, including payments on projects that are currently blocked by opposition from indigenous communities and NGOs. The key clauses under dispute are generally recognized as standard for these kinds of anchor tenant contracts. However, the new leadership at CFE has challenged them in part because it considers the commercialization of foreign natural gas

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Argentina launched a tax credit incentive for the implementation of solar distributed generation, or DG, systems of as much as two megawatts.

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### Brazil Ag Ministry Seeking to Expand Tariffs on Ethanol

The South American country's agriculture ministry wants to eliminate a quota on the number of ethanol imports that are exempt from tariffs.

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## OIL &amp; GAS

### Refineries in Argentina Seeing Jump in Oil Supply

Argentina's refineries are seeing a surge of oil supply due to higher levels of shale oil production, according to the local government of Neuquén Province. The South American country has not imported crude oil for more than a year, according to Governor Omar Gutiérrez.

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Gutiérrez // File Photo: Argentine Government.

## OIL AND GAS NEWS

## Pemex Unveils New Business Plan, Banks Underwhelmed

Mexico on Tuesday announced parts of a much-anticipated business plan for state oil company Pemex but failed to dispel concerns of a ratings downgrade, Reuters reported. Pemex CEO Octavio Romero presented a broad outline of the 200-page plan at a news conference, saying it addressed a profit-sharing tax that hands much of the company's

“The business plan is the first step in a dialogue with the ratings agencies.”

— Arturo Herrera

income to the federal government, making the company financially unsound. He said the tax will be reduced by 11 percentage points to 54 percent by 2021. According to the plan, the move would represent savings of \$6.6 billion over the next two years for Pemex. The plan also includes \$7.2 billion in government financial support over the next three years. The rest of the \$104.6 billion the company has said it will invest during President Andrés Manuel López Obrador's six-year term will come from the company's own revenue, Reuters reported, citing the full document. “The business plan is the first step in a dialogue with the ratings agencies ... We're going to have a permanent conversation,” new Finance Minister Arturo Herrera told journalists, the wire service reported. “What we have to do now is, yes, be concerned about the credit rating but above all concern ourselves with increasing Pemex's production,” he said. However, the plan failed to impress banks, with Citi Research saying in a report that the announced capital injections were “highly underwhelming,” noting that Pemex needs \$10 billion to \$15 billion annually, according to Citi's estimates. Mexico's peso

weakened 0.5 percent against the U.S. dollar after Romero's presentation. Last week, Fitch Solutions said Mexico will face “significant headwinds” for economic growth this year as slow activity in the oil and gas sector weighs on the country's industrial production. Mexico registered its sharpest drop in industrial production in 10 years in May, falling 2.1 percent from the previous month in seasonally adjusted terms, The Wall Street Journal reported. It was the sharpest decline since January 2009, at the height of the global financial crisis, when Mexico fell into a recession. Underinvestment and mismanagement of Pemex has weighed heavily on industrial output, Fitch Solutions said, adding that increased government funds will have a limited impact in the short term. Despite increased funds and support under the López Obrador administration, the company has struggled to reverse a 14-year decline in production. [Editor's note: See related [Q&A](#) in the April 12 issue of the Energy Advisor.]

## Argentine Refineries Seeing Surge in Oil Supply: Local Gov't

Argentina's refineries are seeing a surge of oil supply due to higher levels of shale oil production in the South American country, Neuquén Province's government said Wednesday, S&P Global Platts reported. In May, the country's refineries were operating at a capacity of 78.3 percent, on average, their highest level in seven months, the government's statistics agency, Indec, said earlier this week. The increase in shale oil production was due to the “takeoff in Vaca Muerta,” the location of major shale oil and gas deposits. Argentina's oil production grew 4.2 percent in May to 505,651 barrels per day, according to Argentina's Energy Secretariat. Output from Vaca Muerta has offset declines in the country's conventional oil production. The formation has allowed Argentina to halt crude imports and increase refineries' run rates. Argentina has not imported crude oil for more than a year, and it has started exporting crude, S&P Global Platts reported, citing Neuquén's governor, Omar Gutiérrez.

## NEWS BRIEFS

## CFE Dispute Pushed Mexican Finance Minister to Unexpectedly Resign

Mexican state utility CFE's arbitration dispute over gas pipeline contracts was among the reasons that drove former Financial Minister Carlos Urzúa to unexpectedly resign last week, he said in an interview published Sunday, Reuters reported. “We signed a contract, and we must keep it,” Urzúa told local magazine Proceso. In a harsh resignation letter, Urzúa expressed his disagreements over government decisions that he said were made without sufficient evidence. [Editor's note: See related [Q&A](#) in Wednesday's issue of the daily Latin America Advisor.]

## Renewables Make Up 88.36% of Colombia's Electricity in June

Colombia's renewable sources produced 88.36 percent of the country's electricity in June, equivalent to a daily average of nearly 170 gigawatt-hours, Colombian grid operator XM Compañía de Expertos en Mercados said July 12, Renewables Now reported. Renewables increased power production by 5.66 percent, as compared to the previous month. Hydroelectric power plants were the largest producers of electricity in May, totaling 98.5 percent of the renewables share.

## Argentine Gov't Launches Incentive for 2-MW Solar Distributed Generation

Argentina's government has launched a tax credit incentive for the implementation of solar distributed generation systems of as much as two megawatts, Renewables Now reported Monday. A tax credit certificate of 15,000 pesos (\$360) will be provided for each kilowatt installed, with a maximum of 1 million pesos per installation. The incentive seeks to attract small- and medium-sized enterprises looking to create self-consumption renewable energy.

Crude exports rose 30.1 percent year-on-year in May, to 46,306 barrels per day. The higher run rates are likely to boost production of refined products, which have seen demand slump amid Argentina's recession. Gasoline sales in the country declined 3.7 percent in May to 151,147 barrels per day, while diesel sales declined 1.1 percent to 230,032 that month, according to the Energy Secretariat.

## RENEWABLES NEWS

## Brazilian Ag Ministry Seeking to Expand Tariffs on Ethanol

Brazil's agriculture ministry is looking to eliminate a quota for ethanol imports that are exempt from tariffs, Argus Media reported Monday. The interpretation of a 2017 resolution that established a yearly quota of 600 million liters of tariff-free ethanol imports into Brazil will expire on Aug. 31, unless other-

**A resolution that established a quota on the number of tariff-free ethanol imports to Brazil will expire in August.**

wise extended. Once the exemption expires, a 20 percent tariff would apply to all ethanol imports from outside the Mercosur trade bloc, which includes Argentina, Paraguay and Uruguay. The ministry wants to eliminate that quota altogether, Agra Net reported. Brazil's import and export council, known as Camex, will make the final decision. Camex did not respond to Argus' request for comment. The majority of the South American country's ethanol imports comes from the United States, which has been lobbying to eliminate the tariff. Brazil imported nearly 86 million liters of ethanol in June, the lowest level since last October, according to trade ministry data. Ethanol imports in June

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a low priority relative to generation from domestic fuel sources and in part because it is already fiscally challenged in its titanic effort to modernize and build redundancies so it can provide dependable energy at low costs throughout Mexico. While the desire to use more domestic resources and save money is understandable, we see very little chance for success if the case is taken to arbitration. It would appear that the López Obrador administration may have belatedly

“The arbitration effort has already raised a red flag among the international business community.”

— Pedro Niembro

recognized this as well, having announced a last-minute effort to establish informal negotiations among the affected contractors. Unfortunately, the arbitration effort has already raised a red flag among the international business community by calling into question the strength of AMLO's promise to honor inherited contracts. We believe, however, that the AMLO government recognizes it needs to attract foreign investment and is not anti-business per se, so we are hopeful that a solution can be found to satisfy CFE outside of arbitration. We understand AMLO's desire for strong state-owned productive enterprises, and to achieve this we encourage his government to look to other examples such as Norway's Equinor, which benefits from private investment while remaining solidly under government control.”

**A Greg Ahlgren, partner at Diaz, Reus & Targ LLP:** “The CFE dispute appears inseparable from the broader trade dispute between the governments of Mexico and the United States. Despite the overheated political rhetoric in Washington, the hard eco-

nomie reality is that closed U.S.-Mexico gas ducts are bound to leave South Texas producers in a difficult situation, as they need a destination for excess production. So, perhaps AMLO's strategy is shrewder than it would initially appear, as the United States is now in an extended phase of passing judgment over whether AMLO's government is compliant with Trump's demands concerning border security. The Mexican energy market is an area where AMLO's government has leverage over significant foreign interests. Of course, AMLO's strategy could go awry, spooking foreign investors in the energy sector, but it seems entirely reasonable that all sides to the CFE conflict will work out a solution long before any arbitral proceedings may commence in earnest.”

**A Fluvio Ruiz Alarcón, Mexican energy analyst:** “Despite the fall in associated gas production, increased nitrogen contamination of Cantarell gas and production costs that impede the profitability of major dry gas discoveries, the previous government insisted on basing its energy strategy on this raw material, of which Mexico is highly dependent on exports. Even in the secondary legislation of the energy reform, clean energies were defined in such a way that gas can be considered to be one and thus seeks compatibility between the increase of its use and the country's commitments in terms of emissions reduction to combat climate change—all under the premise of giving greater prominence to the market, to the detriment of the CFE's role. With a new government that has an opposing view about the role of the state in the sector, the main economic clauses of the ‘take-or-pay’ contracts, signed under the previous administration between the CFE and several companies, are a point of friction between the new direction of energy public policies and the institutional design and its tools, which derive from the energy reform. In that sense, recourse to arbitration is a bold ma-

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fell sharply from the 182.5 million liters imported in May but registered a 30 percent increase year-on-year, as compared to the almost 60 million liters imported in June a year ago. The United States was Brazil's largest ethanol seller in the first of half this year, supplying some 856 million liters.

## POLITICAL NEWS

## 'El Chapo' Guzmán Sentenced to Life Plus 30 Years

Joaquín "El Chapo" Guzmán, 62, one of the most notorious drug lords in history, was sentenced Wednesday in a U.S. courtroom to a life sentence plus 30 years in prison. Guzmán was convicted in February on 10 counts, including murder conspiracies, running a criminal enterprise and other drug-related charges. His Mexico-based Sinaloa Cartel trafficked billions of dollars' worth of cocaine, heroin, methamphetamines and marijuana to the United States. At his sentencing in federal court in Brooklyn, N.Y., Guzmán angrily denounced his treatment while in custody at Manhattan's Metropolitan Correctional Center. "When extradited, I expected to have a fair trial where justice was blind and my fame would not be a factor, but what happened was actually the opposite," Guzmán said through an interpreter, *The Washington Post* reported. "I will take this opportunity to say there was no justice here." Guzmán described his confinement as "psychological, emotional, mental torture, 24 hours a day." The drug lord, who personally ordered people's torture and murder, said the conditions in which he was imprisoned demonstrated "a lack of respect for human dignity." Federal sentencing laws required the judge in the case, U.S. District Judge Brian Cogan, to send Guzmán to prison for the rest of his life. "The overwhelming evil is so severe," said Cogan. In addition to the prison sentence, Cogan ordered Guzmán to pay \$12.6 billion in forfeiture, *CNN* reported. Due to the sentencing laws, Guzmán's lawyer, Jeffrey Lichtman, spent little time asking the judge for leniency. "What occurred

## ADVISOR Q&A

### Is the Caribbean Prepared for Hurricane Season?

**Q** A "normal" hurricane season, in line with the annual average of 12 tropical storms forming over the Atlantic Ocean, the Caribbean Sea and the Gulf of Mexico, is expected this year, according to the National Oceanic and Atmospheric Administration. What steps are Caribbean governments taking to prepare for the hurricane season? To what extent have hurricanes and tropical storms held back Caribbean countries' economic growth and social development over the years? What short-term and long-term measures should countries in the region implement to better deal with the preparation for, and recovery from, natural disasters?

**A** Ronald Sanders, ambassador of Antigua and Barbuda to the United States: "The failure of large industrialized countries to drastically reduce greenhouse gas emissions has increased and intensified hurricanes. Caribbean countries have learned that there is no 'normal' hurricane season. The effects of more powerful and destructive hurricanes are multidimensional, including: reversing economic growth; blighting future economic development by skyrocketing insurance premiums that discourage rebuilding; high construction costs to rebuild for greater resilience; insufficient access to concessional financing; the need for larger and more comprehensive country-risk insurance but insufficient revenues to pay the premiums; greater unemployment; enlarged poverty; emigration, particularly of skilled labor; weakened security and increased crime; and high debt due to commercial borrowing for repeated reconstruction. Preparing for these effects is beyond the capacity of Caribbean countries that are the least contributors to greenhouse

gas emissions but are among the greatest victims. Nonetheless, at national and regional levels, Caribbean countries have implemented policies and strategies both to try to withstand hurricanes and to deal with their consequences. These include new regulatory frameworks for stronger building codes and higher building construction standards and building national and regional humanitarian warehouses for storing basic necessities and emergency material for swift distribution. But the measures put in place are plasters for the enlarging effects of climate change that require a meaningful international response from the large, polluting industrialized countries. No country can prepare for the total devastation of an island such as occurred on Barbuda in 2017. U.N. Secretary General António Guterres on July 4 made the point: 'The Caribbean experience makes abundantly clear that we must urgently reduce global emissions and work collectively to ensure that global temperature rise does not go beyond 1.5 degrees above pre-industrial levels.' Guterres also emphasized that, 'There is no way the countries of the Caribbean can recover from a devastating hurricane or systematically build resilience in relation to climate problems based on the unsustainable growth of their debt. This is a common responsibility that the international community needs to recognize.' In short, Caribbean countries have taken the steps their limited capacity allows; the global polluters, which have worsened hurricanes in the region, should be making a more worthwhile contribution."

**EDITOR'S NOTE:** More commentary on this topic appears in Monday's issue of the *Latin America Advisor*.

## NEWS BRIEFS

## Protesters, Police Clash Again in San Juan as Demonstrations Continue

Protesters and police clashed in Puerto Rico on Wednesday in the fifth consecutive day of demonstrations calling for the ouster of Governor Ricardo Rosselló, NPR reported. Demonstrators, including some of the island's famous singers, are pushing for Rosselló to resign following the leak of hundreds of pages of misogynistic and homophobic texts between the governor and his closest aides. San Juan reportedly resembled a "war zone" by the early hours of Thursday, with police chasing protesters while firing rubber bullets, gas canisters and what appeared to be flash bombs.

## Power Plant Breakdowns Caused Cuba Blackouts: Energy Minister

A series of breakdowns in Cuba's power plants caused several blackouts this week across the island nation, according to the country's energy minister, the Associated Press reported today. Energy Minister Raúl García Barreiro told state-run media late Tuesday that three power plants suffered mechanical problems and two others were down as they underwent maintenance.

## USNS Comfort Completes Five-Day Mission in Peru

The United States' USNS Comfort navy hospital ship left Peru on Wednesday, completing a five-day mission to "relieve pressure on national medical systems strained by an increase in Venezuelan migrants," the U.S. Southern Command said in a statement. In Peru, more than 4,500 patients received treatment and more than 100 surgeries were performed aboard the ship. The vessel's medical mission includes stops in Colombia, Costa Rica, the Dominican Republic, Ecuador and several other countries. [Editor's note: See related [Q&A](#) in the July 11 issue of the daily Latin America Advisor.]

here did not uphold an appearance of justice," said Lichtman, The Washington Post reported. Lichtman said he plans to file an appeal. If his verdict and sentencing stand, Guzmán, who famously escaped from Mexican prisons twice, will probably be sent to the U.S. supermax penitentiary in Florence, Colo., after which he will likely never be seen in public again.

## U.S. Secretary of State to Visit Latin America This Week

U.S. Secretary of State Mike Pompeo will visit four Latin American countries and Puerto Rico this week on a trip aimed at addressing regional counterterrorism cooperation, the crisis in Venezuela and migration, The Wall Street Journal reported Tuesday. In addition to visiting the U.S. commonwealth, Pompeo will

**Pompeo's trip includes a visit to Argentina, Ecuador, Mexico and El Salvador.**

go to Argentina, Ecuador, Mexico and El Salvador, followed by a stop in Orlando, Fla., on his way back to Washington. The trip is intended to show the sort of "voluntary, flexible, multilateralism" that the U.S. administration promotes, an unnamed senior official told the newspaper. In Argentina, Pompeo is set to participate in a counterterrorism conference of Western Hemisphere countries, and he is scheduled to hold meetings with Argentine President Mauricio Macri, Chilean Foreign Minister Teodoro Ribera and Bahamian Foreign Minister Darren Henfield. The stop in Guayaquil, Ecuador, is an opportunity for the United States to strengthen its ties to the country, the official said, adding that Venezuela will be discussed. The visit to El Salvador, which the official described as taking an "overtly pro-American" approach, comes just as a new Trump administration rule that eliminates protections for many Central American asylum seekers comes into effect. As of Tuesday, migrants who pass through other countries to get to the United States

are ineligible for asylum at the U.S. southern border. U.S. immigration officials struggled with how to implement the policy, which meant closing the border to some 18,700 asylum seekers currently in Mexico, The Wall Street Journal reported. Most of them traveled from Central America and Cuba. The American Civil Liberties Union filed a lawsuit challenging the new rule on Tuesday.

## Ecuador Aware of Assange Meddling in U.S. Election: Correa

Ecuador was aware that WikiLeaks founder Julian Assange, who took refuge in the Ecuadorian embassy in London for about seven years, interfered in the 2016 U.S. presidential election, former President Rafael Correa said Tuesday, CNN reported. "We did notice ... and we do not allow that because we have principles," Correa said. A report published by CNN on Monday describes how Assange used the embassy as a command center to release a series of documents that influenced the U.S. presidential campaign and claims Assange also met with Russians and world-class hackers.

## ECONOMIC NEWS

## U.S. to Divert Central America Aid to Venezuela: Document

The administration of U.S. President Donald Trump is planning to divert \$41.9 million in humanitarian aid that had been earmarked for Central America toward the opposition in Venezuela instead, Reuters reported Tuesday, citing an internal document. The funds had been destined for Guatemala and Honduras, but a congressional notification from the U.S. Agency for International Development, or USAID, said the money will instead be used for salaries, travel, communications equipment, technical assistance, training and other needs of the Venezuelan opposition.

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never, aimed at reducing costs for the CFE and obtaining some additional resources for investment. However, the fundamental objective seems to be more of a qualitative nature: to make clear the preeminence of the public interest that the state represents above the benefits expected (and already agreed on) by private operators."

**A** **Gonzalo Monroy, managing director of GMEC in Mexico City:** "The rationale for CFE's desire to modify the contracts resides in a poor understanding of how natural gas markets (supply, transportation and marketing) work. The new CFE leadership's lack of experience is evident, as it has failed to grasp simple concepts such as force majeure, in which an unforeseen event occurs. In this case, CFE is claiming that it is 'unfair' that the capacity charges (which represents typically 95 percent of the tariff charged) are being paid during a force majeure. In Mexico's case, as in other developing countries, it is standard practice to include failure to obtain government approval within the force majeure definition, provided the companies have made reasonable, legal and licit efforts to obtain such approvals. CFE disputes this definition in order to recoup payments made during the declaration of force majeure. In terms of perception, the signal sent to the industry and financial markets is dual, and neither is good: first, the sanctity of contracts (essential for investment) is under fire for political reasons, and second, the new administration does not understand the profound transformation of CFE from a utility to an integrated energy company. Unlike Pemex, CFE utilized all the mechanisms granted by the landmark 2013 energy reform to reduce its participation in electricity generation (offset by the flood of cheap generation provided by private parties

under the long-term electricity auctions) in order to have a dominant role in natural gas marketing."

**A** **Héctor Castro, nonresident senior fellow with the Energy, Climate Change & Extractive Industries program at the Inter-American Dialogue:** "There's a basic principle in civil and international law, 'Pacta sunt servanda,' a Latin phrase that means agreements must be kept. At the heart of the dispute are take-or-pay contracts signed under the previous administration that saw CFE footing the bill for gas that was never delivered. CFE's logic is to claim the nullity of clauses that are considered 'abusive' as a result of force majeure for delays sparked by social conflicts, legal injunctions and bad weather. Even though this will not be the first time that a state or company negotiates clauses, the message is a lack of legal certainty. The bad news is that, first, the billionaire amount CFE owes the companies mentioned; second, the construction of pipelines suffered delays for more than a year; third, the period of time it will take for an arbitration resolution; fourth, the social problems related to the location of the pipelines remain; and fifth, natural gas shortages delaying its transportation and causing possible blackouts. Under that scenario, the truce offered by the president is a win-win to avoid the jurisdictional path. It seems unlikely to foresee an arbitration resolution in favor of CFE due to the challenge of proving the 'harmful' or 'abusive' clauses to the detriment of the state. Companies have already started the conversation separately with the government, and I believe there will be a settlement. The main challenge will remain: to clear the obstacles to finish the pipelines aimed at contributing to the natural gas flow that Mexico needs."

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