

Disruption, Uncertainty and Full Speed Ahead: The XXVI La Jolla Conference



Each May, the Institute of the Americas convenes the La Jolla Conference to foster debate and dialogue on our hemisphere's most critical energy policy and investment themes. And each year 2-3 topics dominate the conference's formal presentations, panel discussions, off-the-record roundtables, and cocktail banter. That the uncertainty gripping the globe has not spared Latin America was crystal clear as participants gathered for the XXVI annual La Jolla Conference on May 24-25.

The arrival of the Trump administration has seen an endless catalogue of contretemps, and many that directly and indirectly affect energy policy and the broader relationship between the US and Latin America. But the winds of change and uncertainty are not only blowing through the marble and wood paneled corridors of Washington, DC. Countries across the region have been faced with economic pressures from depressed commodity prices, and political and social unrest has served to somewhat counter efforts to attract investment or push forward major energy policy overhauls, most notably in Mexico and Brazil.

Successive panels and speakers underscored that it is not time for the fainthearted, or risk-averse investor but also pointed to opportunities. The proverbial show goes on and progress is being made. And all of this is occurring at the same time as a major disruption of how the world generates

and consumes energy, and from what sources. Nowhere was this point more evident than the spirited debate that coursed through the conference as to the most appropriate role for renewable energy. Indeed, the conference discourse shifted from the first day's focus on the Trump administration to a no-holds-barred debate on how far and fast renewable energy can be incorporated across the region.

The Trump Administration, US-Mexico and Paris Agreement: Keep Calm and Carry On

Panelists agreed that turmoil appears to be the norm for the new administration in Washington, DC and as UCSD Professor David Victor aptly noted predicting what the Trump administration will do is akin to predicting the path a box of feathers will take after being dumped off a cliff.

With the chaos and uncertainty affecting policy making and broader foreign affairs, panelists concurred that the glacial pace of subcabinet and other appointments in the Trump administration was only proving to exacerbate the ambiguity of the administration's policies. Not unlike his previous business life, the president appears to be running the government and making most if not all decisions with a small close knit cadre of advisors, many of whom are family members.

With all that said, panelists also noted that when it comes to energy policy making in the United States, the role of state government and policies is also important to understand. In that case, discussion focused on the leadership role on energy and climate being exerted in Sacramento and the Brown administration in California.

Fortunately, the hugely divisive rhetoric aimed at Mexico in the early days of the administration has become more tempered, including a more measured approach to NAFTA and possible renegotiations. When it comes to the burgeoning energy trade between the US and Mexico, particularly in terms of natural gas and refined products, it is an important leverage point and one that can and should continue to positively inform the binational relationship in this new era.

Coal too had clearly gained an outsized amount of attention and across the panel there were no expectations for its resurgence. Erin Blanton of Medley Global Advisors succinctly summarized the matter by noting that there is indeed a war on coal underway, and it is called natural gas.

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Debate also centered on how the administration would manage the US commitment to the Paris Agreement on climate change. Keeping in mind the feather metaphor, no one dared make a concrete prediction, but there were signs that in an effort to play to his political base, and the due to the influence of EPA Director Scott Pruitt and advisor Steve Bannon, President Trump would opt to pull out. Soon after the La Jolla Conference the Trump administration did indeed announce its intentions to withdraw the US from the international accord signed in December 2015.

Panelists concurred that uncertainty would continue to reign and throughout the Trump presidency it seems quite apparent that there will be a great deal of noise, bumps in the road, and more twists and turns than a mile's drive on the Big Sur. But, we all would do well to keep calm and carry on as the bark –

so far – has been much worse than the bite as one panelist summarized.

100% Renewable Energy: Yes or No?

As the panels and discussions continued on the conference's second day, the dominant topic shifted. Indeed, the conference went from being all about Trump to an all-out debate on how far and fast renewable energy can be incorporated across the region. Regardless of the panel, the topic of where renewables fit into the region's energy mix, and at what percentage, what price, and at what pace percolated through the discussions.

Those advocating a very forward-leaning 100% renewable energy posture – call them the California contingent – went head to head with the more moderated energy transition view, one that in most cases includes a critical role for natural gas. But make no mistake that no one argued against renewable energy, rather it was a debate over how much renewables should we rely upon and when.

For years, at the La Jolla Conference and in myriad energy discussions, the dual issues of price and intermittency dominated the renewables conversation. But, according to CEO's Rolando Gonzalez Bunster and Carlos Barrera, former Brazilian government official Mauricio Tolmasquim, and Angelina Galiteva of the California ISO, these issues have been largely resolved.

Advances in storage and technologies to balance the grid have and will continue to be the keys to overcoming these hurdles. Angelina Galiteva pointed to the fact that on some days, California is already exceeding the 50% threshold of renewables on the grid. She further suggested that due to the aforementioned advances renewables can balance renewables – the long-held belief of the need for baseload power no longer exists, but rather what are required instead are flexible resources.

Panelists argued that the renewable wave sweeping the region, and the reason for the daylong debate over the efficacy of a 100% renewables target, are the fact that governments are seeking renewables not just for climate and emissions reductions goals, but rather for cost reasons. These cost reductions are driven by technology, efficiency gains, and an unleashing of financing and capital. Interestingly, the perception of risk has changed: solar energy is now seen as less risky than wind and hydro one panelist underscored. Add to that the fact that nearly all commercial banks as well as pension funds want exposure to solar energy projects and deals.

Mexico: Reform, Complex as Ever Proceeds Apace

Despite social unrest, a sluggish economy and the long shadow cast by the US election and unfortunate spotlight placed upon the country by the new administration, Mexico has made considerable progress with its energy reform. Representatives from Pemex, CNH and ASEA all touted the massive regulatory reform that has in many cases been enacted from scratch, along with the continued advance and attraction of upstream oil and gas investment. By the time of the conference, more than two billion dollars had been invested by way of 34 projects tendered since the reform became law.

The audience was keenly interested in the perspectives from Pemex presented by Gustavo Hernandez director of resources, reserves and associations at Pemex Exploration and Production. Picking up some of the key messages he delivered in 2016, he offered an update and focused on the progress made with opportunities in partnerships, specifically partnerships with other companies such as their successful farm-out with BHP Billiton and joint venture project with Chevron. Hernandez also discussed the firm’s current business plan and outlined its main objectives: 1) Maximizing profitability; 2) Increasing productivity and efficiency; and, 3) Accelerating the implementation of the energy reform.

Hernandez argued that Pemex is working hard to establish an exploration model, accelerate shale development, contain and reverse the decline of production, carry out farm outs to develop complex fields, capture investment, increase gas production and increase operational efficiency and reinforce operational efficiency.

Meanwhile, the country’s natural gas and electric markets have undergone radical and profound change, with a major restructuring of state power company CFE. In addition, Mexico has garnered international attention with auctions for renewable energy that has brought world-class projects and prices. Panelists from Mexico concurred that much work remained in order to consolidate the reform, but none shied from the demands ahead nor were they overly concerned with the impending election cycle and its populist shadows.

Brazil and Guyana: Reset and Transformation

In the lead up to the La Jolla Conference, Brazil had commanded considerable attention particularly for the continued political strife but also its economic reform agenda, with energy as a key element. The seemingly never ending carwash scandal and assorted political corruption offshoots continue to rock the country and cast doubts as to the tenure of President Michele Temer, who replaced the ousted Dilma Rousseff in 2016.

The Temer administration has set in motion, however, an aggressive reset and reform agenda for the nation’s energy sector and particularly investment in the upstream. Over the last several months, major regulations have been rewritten pertaining to oil and gas investment, and a moribund effort to draw investment via auctions at the National Petroleum Agency (ANP) has been jumpstarted.

A calendar of bidding rounds for the first time ever

	Future Bidding Rounds	Focus	Date
2017	14 th Bidding Round	East Margin and Onshore Basins	27 th September
	2 nd Production Sharing Bidding Round	Gato do Mato, Carcará, Sapinhoá and Tartaruga Verde	27 th October
	3 rd Production Sharing Bidding Round	Peroba, Pau Brasil, Alto de Cabo Frio Oeste and Alto de Cabo Frio Central	27 th October
2018	15 th Bidding Round	Equatorial Margin and Onshore Basins	May, 2018
	4 th Production Sharing Bidding Round	Saturno, Três Marias, Uirapuru, C-M-537, C-M-655, C-M-657 and C-M-709	May, 2018
	5 th Marginal Fields Bidding Round	To be defined	To be defined
2019	16 th Bidding Round	East Margin and Onshore Basins	3 rd Q 2019
	5 th Production Sharing Bidding Round	Aram, Bumerangue and SE Lula, South and SW Júpiter	3 rd Q 2019
	6 th Marginal Fields Bidding Round	To be defined	To be defined

Source: Decio Oddone, ANP Presentation

The efforts in place and reforms in motion led Institute of the Americas Board Member Paulo Sotero to note that despite the difficult situation there is room for optimism for the energy reset. His comments echoed a keynote address by the Director General of ANP Decio Oddone. Oddone’s presentation set forth the plans the regulatory agency is taking in order to attract greater investments and described this moment as historical for Brazil. Oddone outlined four variables that could serve to revitalize the sector: 1) The agenda of tenders for new exploration areas; 2) The improvement of policies in the area of energy and regulation; 3) The modernization of the supply chain; and 4) Petrobras’ divestment plan.

With regards to the country’s electric sector, Rafael Ferreira

an advisor to the CEO at Energy Planning Agency EPE noted that the economic downturn had stressed the power model and efforts are underway to decentralize decision-making, improve use of market signals, and allocate more risks to agents. In addition, the government is undergoing an effort to review incentives for renewables, separate out capacity and ancillary services markets, expand the deregulated market, all the while respecting existing contracts and property rights. The goal, he underscored, is to redefine the role of the government in the power sector with a heavy dose of realism guiding actions taken to date.

Guyana also figured prominently with its recent deepwater oil discoveries in the Liza and Payara fields operated by ExxonMobil. The country surely stands on the cusp of a historical and transformational opportunity. With a population under one million inhabitants, Guyana is already preparing to export its oil starting in 2020 from these two fields that are considered among the largest discoveries in South America.

But, as panelists noted, the road to oil wealth over the next three years is one fraught with examples of what not to do. Indeed, transparency and effective planning on how to use massive oil revenues are among the major issues facing Guyana and particularly the government as it negotiates with ExxonMobil and its partners. Government and society face a steep learning curve as heretofore nonexistent institutions are stood up, regulatory practices are implemented, and energy governance is developed.

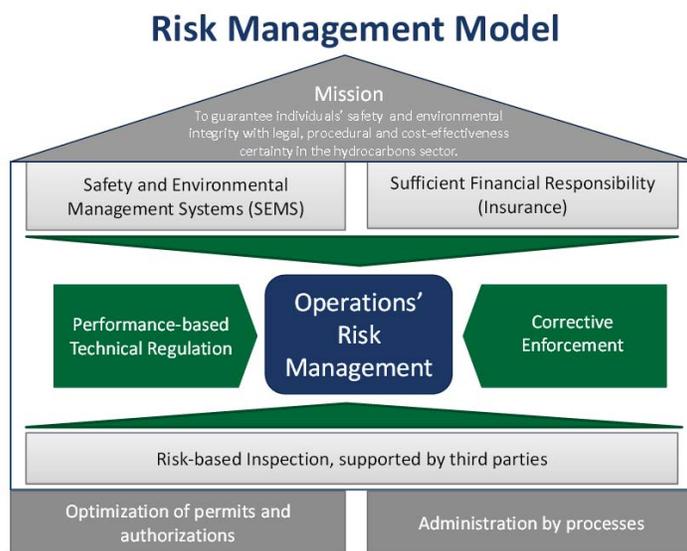
Stakeholder Engagement and the Exercise of Regulation: Collaboration

The largest panel, both in terms of panelists and topics covered, was that centered on regulation, the role of stakeholder engagement and balancing regulation and investment. The discussion ranged across the oil and gas sector, but also examined the electric sector and particularly large scale projects and transmission lines.

Panelists agreed that companies have a social responsibility to the communities, the so-called social license to operate. And it is important to keep in mind that a project does not end until long after its completion, in some cases 25 years after, when the project is now embedded in the community and it is successful. But at the same time, there is not a one-size fits all regulation or model for community engagement; different activities have different level of risks, and should be regulated and managed according to the risks.

Carlos de Regules of Mexico’s safety and environment regulator ASEA noted that a healthy debate and assessment over whether

regulation should be prescriptive or risk-based in Mexico led to a decision to pursue a more risk-based model that strives to create and depend upon trust and credibility, key factors for any regulatory model. Jaime Martinez of consulting firm ERM argued, however, that in Mexico, regulators need to truly embrace the risk-based model and imbue credibility, so that the operator can have freedom and think about the risks of their operations. He argued for an approach that would allow companies to conduct a comprehensive exercise to identify real risks and thus encourage companies to focus on the actual activity and not just evaluate the operations on paper.



Carlos de Regules, ASEA, Presentation

When queried as to the keys to effective regulation, one that balances investment with risks and manages stakeholder engagement, the panelists responded with a variety of thoughts: “Be consistent in the long term,” one noted. “Above all else strive for transparency, that is tell people what you are doing,” suggested another. “Be brave when you make a mistake; say how you are addressing it,” cautioned another. “Collaboration,” one responded succinctly.

The Institute of the Americas’ Energy & Sustainability Program works to foster a deeper understanding of the Western Hemisphere’s most critical energy and sustainability issues. For more information and upcoming events, follow us on Twitter @IOA_Energy or visit: www.iamericas.org/energy

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