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# Transactional, Social, and Legal Aspects of Oil Exploration and Extraction in Colombia

Juan Carlos Palau\*

## I. INTRODUCTION

Since the discovery of the Cusiana and Cupiagua fields in 1991 and 1993, respectively, Colombia's oil industry has become increasingly important.<sup>1</sup> These discoveries increased, by 1.2 billion barrels (b/bls),<sup>2</sup> the country's total proven oil reserves, which now add up to approximately 2.6 (b/bls).<sup>3</sup> This Latin American nation's potential is more significant when taking into account official estimates that a total of 24 to 30 (b/bls) are still to be proved,<sup>4</sup> making it comparable to Qatar one of the smallest of the OPEC members in terms of oil reserves.<sup>5</sup> Colombia's oil is lighter and

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\* Of Counsel, Prieto & Carrizosa S.A. To Armando's teachings...

<sup>1</sup> Colombia, at <http://www.eia.doe.gov/emeu/cabs/colombia.html> (last visited Feb. 2000).

<sup>2</sup> *An Energy Overview of Colombia*, at <http://www.fe.doe.gov/international/colbover.html> (last visited July 2001).

<sup>3</sup> *Ajustes a la política petrolera: Nueva Visión Contractual*, Carta Petrolera, paragraph 3 (Nov.-Dec. 1997) available at <http://www.ecopetrol.com.co/prin/review/carta/nov99/cartand.html>.

<sup>4</sup> *Mayores oportunidades de inversión petrolera*, Carta Petrolera, page 5, paragraph 2 (Sept.-Oct.1997) available at <http://www.ecopetrol.com.co/prin/review/carta/nov99/cartand.html>.

<sup>5</sup> OPEC has a total of 805.0 giga billion barrels (gbbls) in proven oil reserves. *Reservas de Petróleo de la OPEP*, available at <http://www.ecopetrol.com.co/esop/esopet/1999/estadisticas1999.htm> (last visited May 2001). This is approximately 80 percent of the world's 1016.0 (gbbls). *Reservas Mundiales de Petróleo*, available at <http://www.ecopetrol.com.co/esop/esopet/1999/estadisticas1999.htm> (last visited May 2001). OPEC's members, in decreasing order, are Saudi Arabia with 262.784 (b/bls), Iraq with 112.5 (b/bls), United Arab Emirates with 97.8 (b/bls), Kuwait with 96.5 (b/bls), Iran

sweeter than that of its Latin American neighbors, and 50% of its production is exported to the U.S.<sup>6</sup>

Nevertheless, it has been estimated that at the current rate of production, Colombia would cease to be a net oil exporter by the year 2004.<sup>7</sup> Thus, serious challenges still lie ahead if the country wishes to continue on the path to acquiring an oil-rich status. The challenges are more daunting after taking into account the fact that, since the time of the discovery of the Cusiana and Cupiagua fields, the national economy has become increasingly dependent on oil revenues.<sup>8</sup>

Accordingly, the main priority in Colombia's oil policy is to increase production and to attract foreign investment for the exploration and exploitation of additional sources and existing ones.

Since Colombian companies lack the capital and technology necessary for such a costly, risky and complex undertaking, foreign companies mostly conduct the exploitation and exploration of oil.<sup>9</sup> As a practical matter, petroleum prospecting – the industry's jargon for finding oil – is not an easy task. Subterranean information is gathered and subsequently interpreted to determine the existence of locations where the necessary geologic elements forming a reservoir are present.<sup>10</sup> Traditionally, this has been carried out by pounding the earth with a truck-installed vibrator, or by exploding small charges underneath it.<sup>11</sup> The length of the time intervals between waves reflected from rock determines the formation's distance from the surface.<sup>12</sup> Today's modern technology has significantly reduced the randomness of petroleum prospecting using satellites, which enable the mapping of oil fields with remarkable accurateness and a low impact on the environment.<sup>13</sup> However, the existence of hydrocarbons can still only be confirmed by

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with 93.1 (b/bls), Venezuela with 76.8 (b/bls), Socialist People's Libyan Arab Jamahiriya with 29.5 (b/bls), Nigeria with 22.50 (b/bls), Algeria with 11.3 (b/bls), Indonesia with 4.9 (b/bls), and Qatar with 3.7 (b/bls), available at <http://www.opec.org> (last visited May 2001). The region with the second largest amount of reserves is Latin America, with 12 percent of the world's total, *Estadísticas de la Industria Petrolera 1999*, available at <http://www.ecopetrol.com.co/esop/esopet/1999/estadisticas1999.htm> (last visited May 2001).

<sup>6</sup> Colombia, *supra* note 1.

<sup>7</sup> *Id.*

<sup>8</sup> This accounts for up to 35 percent of the government revenue, available at <http://www.eia.doe.gov/emeu/cabs/colombia.html> (last visited July 2001). *Id.*

Currently there are 43 foreign oil companies operating in the country. *El Petróleo en Colombia*, at <http://www.ecopetrol.com.co/prin/petroleo/petrol.htm> (last visited May 2001).

<sup>9</sup> These elements include a source rock that generates hydrocarbons, a reservoir rock, which holds them, and a structural trap that acts as a lid by not allowing them to leak away. *A Petroleum Prospecting Primer*, at <http://www.chevron.com/about/learningcenter/primer/index.shtml> (last visited May 2001).

<sup>10</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

“wildcatting,”<sup>14</sup> or drilling rotary tools into wells that are sometimes as far as five miles from the earth's surface.<sup>15</sup>

In Colombia, as in many other countries with oil reserves potential, the government has sought to reduce the activity's inherent high degree of uncertainty by shaping the legal and economic environment that foreign companies have to operate in, making it more profitable and attractive for them.<sup>16</sup>

This paper seeks to accurately represent this environment to the prospective investor, starting with the structures of the two basic transactions, referred to herein as “modes”, through which most commonly, foreign companies participate in the oil industry in Colombia, namely, the Standard Association Mode (“S.A.M”) and the Risk Sharing Mode (“R.S.M.”).<sup>17</sup> The contractual agreements corresponding to these modes are standardized and allow little tailoring to fit individual company needs.

This part of the analysis will also include recent modifications to the foregoing modes, introduced to meet the government's announced oil-policy objectives of increasing production, exploiting the existing reserves, and finding additional ones. In addition, a brief examination of the taxation regime will be followed by a discussion of the regulation implemented to protect the environment and Colombian minority ethnic groups.

## II. BASIC LEGAL FRAMEWORK

Law 165 chartered Ecopetrol, a government business corporation, in 1948 with sufficient powers to explore and exploit the country's oil.<sup>18</sup> How-

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<sup>14</sup> This expression is taken from “wildcatters”, which refers to the early oil explorers who were said to drill anywhere they landed. *Exploration and Production, Finding Oil and Gas*, at <http://www.shell.com/eandpen/content/0,4053,27188-52909,00.html> (last visited Oct. 5, 2001).

<sup>15</sup> The drilling rate varies depending on the hardness of the rock. The average speed of a drill is 198 feet per hour but it can be as slow as 99 feet per hour when the rock is very hard. *Down the Hole*, at [http://www.shell.com/b/bl\\_01a5.html](http://www.shell.com/b/bl_01a5.html) (last visited Nov. 1998).

<sup>16</sup> In Colombia, like in many civil law countries, the legal and political conception exists according to which the subsoil is the people's property. Thus, technically, as stipulated by article 102 of the Colombian Constitution, the government owns the mineral resources and has the obligation to administer them commensurate with the general interest. See CONSTITUCIÓN POLÍTICA DE COLOMBIA art. 102.

<sup>17</sup> Other modes were implemented in October 1997 for areas about which there is little geological information, such as areas that are distant from roads and other means of transportation, small areas for which production is estimated under 30 million barrels (“bls”) and areas with a diminishing rate of production. However, this experience was only partially successful because few companies adhered to these modes after they were introduced.

<sup>18</sup> Ley 165, Diario Oficial, Dec. 27, 1948 [26904], at 998. In civil law countries, as in Colombia, the main sources of laws are acts of the national legislature. There are no local legislatures. As opposed to the common law, court holdings are binding only in exceptional cases, subject to certain limitations. Thus, when referring to a “law” in this context, it is not a court holding, but an act of Congress.

However, due to capital restraints, Decree 2310 further defined Ecopetrol's charter, enabling it to hire private companies through association agreements or any other kind of service or production agreement except concessions.<sup>19</sup> Thus, Ecopetrol is the exclusive enterprise with which the private contractor must deal.<sup>20</sup>

### III. STANDARD ASSOCIATION MODE ("S.A.M.")

This mode was first introduced during the 1970's.<sup>21</sup> Foreign companies are associated upon their showing of interest and are not submitted to any kind of bidding process.<sup>22</sup> Consequently, based upon reasonable considerations, Ecopetrol can associate any company it wishes without the risk of other interested companies instituting an action against its decision.

Chronologically, this mode initiates with an exploration stage during which, at its own expense and risk, the associate company independently explores the area to determine more precisely the presence of oil.<sup>23</sup> This is done by reprocessing seismic information already available that Ecopetrol has the duty to furnish, and by gathering new information.<sup>24</sup> The associate then drills several orifices to confirm the existence of a well.<sup>25</sup>

Subsequently, if oil is not found after a period of time (which may last from three to six years, as will be explained when referring to the agreement's duration) the associate loses the investment made in exploring the area.<sup>26</sup> On the other hand, if oil is discovered, the parties enter a transitional period during which Ecopetrol independently assesses whether the new well can be exploited at a profit.<sup>27</sup> A positive conclusion to this thorough

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<sup>19</sup> Decree No. 2310, Diario Oficial, Oct. 28, 1974 [34201], at 313. Decrees are similar to regulations in the U.S. legal system. They specify the meaning of laws. The government agency in charge of the specific matter enacts them. A concession in this context means to grant the use and benefit of the land.

<sup>20</sup> Nevertheless, Ecopetrol leads activities that are more within its financial reach.

<sup>21</sup> *El Petróleo en Colombia*, at <http://www.ecopetrol.com.co/prin/petroleo/petrol.htm> (last visited May 2001).

<sup>22</sup> *Proceso de Negocio*, at <http://www.ecopetrol.com.co/ecop/explor/exp.htm> (last visited May 2001).

<sup>23</sup> Section 5 Standard Association Mode [hereinafter S.A.M.].

<sup>24</sup> Sections 5.1.1 and 6.1. S.A.M.

<sup>25</sup> Sections 5.1.1, 5.1.2, 5.2 S.A.M. The amount of seismic information to be processed and the number of holes to be drilled are specifically determined in each case. This is one of the few instances where there is negotiation by the parties. All of the information, which has to be transferred to Ecopetrol, will remain strictly confidential during a period of three years starting from the exploration phase. Sections 6.1 and 6.2 S.A.M.

<sup>26</sup> Section 5.4. S.A.M. This risk is not so high given the geological certainty of the area.

<sup>27</sup> Section 9.1 S.A.M. If Ecopetrol doesn't find the well to be commercially viable, the associate can choose to develop the well by itself and will have the right to receive 200 percent of the cost (the investment in infrastructure and equipment used) of the activities it carried out on its own plus 50 percent of the expenses incurred before Ecopetrol determined whether or not the well was profitable. Section 9.10 S.A.M. Ecopetrol can then decide to

evaluation marks the beginning of the exploitation phase and earns the associate the right to be reimbursed for 30% of the investment made in exploration.<sup>28</sup> The currency feature was introduced in the mode in October 1997. It is designed to reduce the exchange rate risk of the operation and is consistent with the government policy of encouraging foreign investment.

At the beginning of the exploitation phase, the foreign company will be solely responsible for exploiting and managing the well.<sup>29</sup> Both parties will share the cost of the exploitation in proportion to their share of the production. Exploitation will take place under the supervision of a specially assigned committee.<sup>30</sup> Specifically, this committee, composed by one member from each party,<sup>31</sup> will have the responsibility of determining if the obligations under the mode's terms are being adequately performed and are controlling the annual and long-term expenses incurred by the associate.<sup>32</sup>

As the well manager, the associate is in charge of allocating each party's share of the production.<sup>33</sup> The associate is entitled to 70% of the production before it reaches 60 million barrels ("bls").<sup>34</sup> From that point on, distribution is determined by the profitability of the well through the use of a cost return factor.<sup>35</sup> Thus, compensation for both parties is the volume

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participate in the operation. Section 9.6 S.A.M. Reimbursements are made with the production proceeds. Section 21.2 S.A.M. In any event, whether having participated or not in the well's development, Ecopetrol receives part of the well's production. Section 14.2.2 S.A.M.

<sup>28</sup> This percentage was decreased from 50 percent in July 1999, given that the share of the production received by the associate was increased. The associate will receive interest determined at the Colombian rate. Section 9.2.3 S.A.M. The amount, including interests plus principal, will be indexed according to the international inflation rate determined by the International Monetary Fund. Section 9.2.3 S.A.M.

<sup>29</sup> Section 10.1 S.A.M.

<sup>30</sup> Section 19.1 S.A.M.

<sup>31</sup> Section 18.1 S.A.M. Each party has 50 percent of the voting power. See Sections 18.4 and 22.2 S.A.M. If both parties do not agree on a particular issue, they may nominate an expert and undertake to abide by his or her opinion. If the parties do not agree on whom to nominate, they undertake to accept the appointment of an expert by the Colombian Society of Engineers. Section 28.3 S.A.M. This does not apply to any legal disputes.

<sup>32</sup> Section 19 S.A.M. For this purpose, the foreign company must implement an annual budget along with a development plan. Section 11.1 S.A.M. The annual budget comprises and limits all of the operations expenses, while the development plan is designed to provide an idea of how the activities will evolve in five years. Sections 11.4 and 11.1.2 S.A.M. Under no circumstance can the foreign associate incur any expense, which is not included in the budget if it is over US \$ 40.000 without the committee's authorization. Section 11.6 S.A.M.

<sup>33</sup> Section 12.3 S.A.M.

<sup>34</sup> Section 14.2.1 S.A.M. This percentage was increased from 50 percent in July 1999.

<sup>35</sup> Section 14.2.2.1 S.A.M. This ratio is determined by the following formula:  $R = \frac{\text{accumulated income} / [\text{dwell development investment} + (\text{exploration cost} - \text{reimbursed exploration costs})]}{>+ \text{operation costs}}$ . The accumulated income is the value of the total production, the dwell development investment is the amount invested in developing the well to begin production. Section 14.2.3 S.A.M. The R factor is then used in another formula as described in the following tables:

of oil extracted, which can be at least 70% of 60 million bls for the associate or at least 30% of 60 million bls for Ecopetrol, depending on the returns of the operation. The parties are free to dispose of their share of the production at will.<sup>36</sup>

Regarding the agreement's duration, it can vary considerably between three and twenty-eight years, depending on various circumstances. If exploration shows no positive results after a period of three years, the associate may choose to continue exploring after agreeing with Ecopetrol upon yearly extensions with a limit of six years.<sup>37</sup> On the other hand, the associate may also choose to terminate the operation after the three-year term or any of its extensions without any penalty.<sup>38</sup> If oil is found, a maximum period of twenty-two years is available to extract the reserves.<sup>39</sup> Any of the two parties' failure to perform its duties during this term before expiration constitutes an event of default under the agreement.<sup>40</sup>

Events of default under the agreement by the associate are unilaterally declared by Ecopetrol if the associate company does not comply with any of the terms and conditions agreed upon and it ceases to legally exist.<sup>41</sup> After declaring an event of default, Ecopetrol may cease to perform its duties under the contract without defaulting.<sup>42</sup> On the other hand, a default by

R Factor	Associate's Share	Ecopetrol's Share
< 1.5	70%	30%
1.5 -2.5	$70/(R-0.5)$	$100-(70/(R-0.5))$
> 3.0	35%	65%

Section 14.2.2.1 S.A.M. Agreement. Before December 1999, the R factor scale's starting point was increasing from 1.0 to 1.5 as indicated in the table. Consequentially, the well has to be more profitable now than it had to be then for Ecopetrol to be entitled to a share of the production greater than 30 percent. This, of course, increases the enterprise's attractiveness significantly for foreign associates.

<sup>36</sup> Section 14.1 S.A.M.

<sup>37</sup> Section 23 S.A.M.

<sup>38</sup> Section 26.1 S.A.M. Nevertheless, the duty of gathering and processing seismic information and conducting drillings as stipulated in the agreement still has to be fulfilled.

<sup>39</sup> Not later than five years before the ending of this term, Ecopetrol and the associate may agree to extend the exploitation period, at which point new terms and conditions may be proposed and considered within the limits of the same S.A.M. regarding duration, production distribution, events of default, termination, indemnification, dispute resolution and assignability. Section 23 S.A.M.

<sup>40</sup> CÓDIGO CIVIL [C. CIV.] art. 1546 (Colom.).

<sup>41</sup> Section 25 S.A.M.

<sup>42</sup> C. CIV. art 1546. As opposed to the associate's duties under the agreement, Ecopetrol's duties during the exploitation phase aren't clearly specified. One can imply, however, they are to protect the associate against any party judicially claiming to own the area; to designate a representative to the controlling committee; not to interfere with the associate's exploitation of the reserves under the agreement; to reimburse 30 percent of the exploration costs; to finance 30 percent of the costs of exploitation and to appropriate its share of the production including the percentage corresponding to royalties.

Ecopetrol would have to be adjudicated by a court.<sup>43</sup> This is very onerous to the other party since it implies it would have to wait for a court decree to discontinue its performance under the agreement. In addition, the lack of specification of events of default by Ecopetrol in the agreement brings uncertainty to the associate since it would be subject to a court's interpretation as to what Ecopetrol's duties were and under what standards they are to be performed.

On the other hand, the occurrence of an event of default by the associate company before the seventeenth year, starting from the date of the agreement, automatically triggers the associate's obligation to indemnify Ecopetrol by selling to it the associate's interest in the operation at commercial or book price, whichever is lower.<sup>44</sup> If default takes place after the seventeenth year, the corresponding interest would have to be transferred free of cost.<sup>45</sup> On the other hand, if Ecopetrol defaults under the agreement no indemnification is specified. Thus, similar to the lack of definitions of events of default by Ecopetrol, this is considerably onerous since it means the associate would be subject to a court's quantification of the loss to determine the appropriate remedy.<sup>46</sup>

In addition to the option to terminate without penalty at certain stages during the agreement (i.e. after the three year exploration term or any of its extensions), the associate may also legally end the contractual relationship by alleging force majeure – defined as a strike, war, earthquake, or flood – and the enactment of any law that makes the execution of the agreement impossible.<sup>47</sup> This option can work in the associate's favor, given the high regularity with which these events take place in Colombia.<sup>48</sup>

With respect to its assignment, the agreement cannot be freely transferred without the consent of Ecopetrol and the Minister of Mines.<sup>49</sup> This reduces the associate's ability to easily retract from an undertaking, which,

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<sup>43</sup> C. CIV. art 1546.

<sup>44</sup> Section 22.10 S.A.M.

<sup>45</sup> Section 26.2 S.A.M.

<sup>46</sup> Upon determining that in fact Ecopetrol has breached the agreement, courts may alternatively terminate the agreement and award damages to the associate or force Ecopetrol to continue with its duties under the agreement and award damages, depending on the plaintiff's petition. C. CIV. art 1546.

<sup>47</sup> Section 34 S.A.M.

<sup>48</sup> Oil production has been the main target of attacks from guerrilla groups who resent the presence of foreign companies in the country. As an example, the main pipeline, "Cano Limon-Covenas", through which most of the country's oil is transported from the interior to the Atlantic sea to export, has been attacked 526 times since 1982, spilling more than 1.6 million barrels, causing enormous ecological disaster. These attacks forced Occidental Petroleum, the major private operator of the pipeline, to incur higher operating costs of about \$13 million in 1997, *Colombia, supra* note 1.

<sup>49</sup> Section 27.1 S.A.M.



for various reasons, may not prove economically beneficial to it, thus affecting the commercial attractiveness of the investment.

Colombian law governs the contractual relationship, and any dispute arising from it will be resolved in Colombian courts, pursuant to administrative procedure rules.<sup>50</sup> No arbitration clause is included in the agreement. This has highly unfavorable results on the parties, given the length of time it usually takes for disputes to be resolved in the Colombian court system. This also means the parties will not be able to enjoy the benefits of having of people they deem qualified and competent as arbitrators.

As a final aspect, the associate company also must undertake to purchase liability insurance to protect Ecopetrol against any losses suffered under the agreement and any other third party affected against tort liability.<sup>51</sup> Insurance covers all the risks the committee deems convenient.<sup>52</sup>

#### IV. RISK SHARING MODE ("R.S.M.")

This mode was introduced during the 1970's together with the S.A.M.<sup>53</sup> Unlike under the S.A.M., foreign companies are not associated freely but after an auction process the winner of which is the bidder that offers the largest share of the production to Ecopetrol, starting from a minimum base of 50%.

Chronologically, the same exploration and exploitation stages exist.<sup>54</sup> Basically, however, the only difference in relation to the S.A.M., is that the foreign associate's and Ecopetrol's roles reverse. Since the beginning of the first stage, the state company explores the area. The costs of doing so are split with the associate.<sup>55</sup>

The parties undergo the same transition period to assess the profitability of the well.<sup>56</sup> This evaluation however, is not carried out solely by Ecopetrol but together with the associate through the same specially assigned committee that will later on supervise the performance of the agreement during the exploitation phase.<sup>57</sup> Thus, under this mode the committee functions in the same way as in the S.A.M. regarding composition and deci-

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<sup>50</sup> Section 35 S.A.M.

<sup>51</sup> Section 39 S.A.M.

<sup>52</sup> Section 33 S.A.M. This does not include depreciation.

<sup>53</sup> *El Petróleo en Colombia*, at <http://www.ecopetrol.com.co/prin/petroleo/petrol.htm> (last visited May 2001).

<sup>54</sup> Chapter II and III, Risk Sharing Mode [hereinafter R.S.M.].

<sup>55</sup> Sections 5.1.1. and 8 R.S.M. Notice that the costs here are split since the beginning. Ecopetrol does not earn the right later on to be reimbursed as the associate does in the S.A.M.

<sup>56</sup> Section 10.1 R.S.M.

<sup>57</sup> Section 10.1 R.S.M.

sion making, but it starts operating right before the transition period, not after it as in the former mode.<sup>58</sup>

A positive conclusion to the transitional period marks the beginning of the exploitation phase.<sup>59</sup> Ecopetrol will act as the operator, solely in charge of distributing the production under the same supervision of the specially assigned committee.<sup>60</sup> Both parties will bear the cost of exploitation in the same proportion as its share of the production.<sup>61</sup>

Regarding production distribution, the associate is entitled to the percentage proposed during the auction and Ecopetrol to the rest, before reaching a cap of 60 million (bls).<sup>62</sup> From that point on, each party's share is determined through the used of a cost return factor different than the one used in the S.A.M.<sup>63</sup>

The terms pertaining to duration, events of default, dispute resolution, force majeure, assignability, and insurance are the same as in the S.A.M. Sections 33-36, 38, 39, 40 and 42 R.S.M.<sup>64</sup> Thus, the same certainty and favorability analysis to the associate applies. Regarding indemnification, however, because Ecopetrol is the operator, the equipment wouldn't have to be transferred to it. Instead, Ecopetrol would automatically be transferred the ownership of the whole operation.

The option to terminate the agreement without penalty at certain stages during the agreement (for example, after the three year exploration term or any of its extensions) is also provided under this mode.<sup>65</sup>

<sup>58</sup> Sections 24, 25 and 26 R.S.M.

<sup>59</sup> Section 10.2 R.S.M.

<sup>60</sup> Sections 27.1 and 27.2 R.S.M. The committee also controls the annual and long term expenses incurred by the operator. Section 25.3.4 R.S.M.

<sup>61</sup> Sections 13.1 and 13.2 R.S.M. The same as in the Standard Association Mode applies, *see supra*, note 26. Section 11 R.S.M.

<sup>62</sup> Section 20.1.1 R.S.M.

<sup>63</sup> Section 20.1.2. This ratio is determined by the following formula:  $R = \text{accumulated income} / (\text{dwell development investment} + \text{exploration cost} + \text{operation costs})$ . The accumulated income is the value of the total production, the dwell development investment is the amount invested in developing the well to begin production. The R factor is then used in another formula as described in the following tables:

R Factor	Associate's Share	Ecopetrol's Share
< 1.0	50 - X	50 + X
1.0-2.0	$(50-X)/R$	$100 - ((50-X)/R)$
> 2.0	$(50-X)/2$	$100 - ((50-X)/2)$

R.S.M. Agreement, Section 20. Where X is the percentage of the production offered by the associate in the auction.

<sup>64</sup> Sections 33-36, 38, 39, 40 and 42 R.S.M.

<sup>65</sup> Section 34.1 R.S.M.

## V. TAXATION

It is important to bear in mind that production of gas or oil is distributed only after having deducted 20% of the total.<sup>66</sup> This deduction is mandatory by virtue of article 360 of the Colombian Constitution, which states that the municipalities and departments<sup>67</sup> where companies extract natural resources are entitled to a certain percentage of royalties.<sup>68</sup>

Colombian central governments<sup>69</sup> assess oil producers with an annual 35% income tax,<sup>70</sup> a seven percent tax over dividends remitted to foreign countries,<sup>71</sup> a 1.5% stamp tax on all executed documents with a face value equal or greater than approximately US \$25,000<sup>72</sup>, a 6% pipeline transportation tax,<sup>73</sup> and a 16% value added tax on most goods and services.<sup>74</sup> A three percent tax on all financial transactions, including withdrawals from checking and savings accounts, is also assessed.<sup>75</sup>

Oil production is a main target of attack by guerrillas, who oppose exploitation by foreigners and believe the government should have a larger role in production. Thus, companies have to make two special contributions to the army for defense expenses. The first one imposes \$1 per barrel produced, which gradually has been decreased starting since 1998 and will be extinguished completely in 2001. The second contribution, also manda-

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<sup>66</sup> Sections 14.2.1 S.A.M. and 20.1.1 R.S.M. The government recently introduced a new royalty distribution method. Royalties will not be fixed at 20 percent but at 5 percent and will increase with production. Therefore, if production is within a range from 5,000 barrels per day (bbls/d) to 125,000 (bbls/d) the royalty percentage will vary between 5 percent and 20 percent. With a range between 125,000 (bbls/d) and 400,000 (bbls/d), the royalty percentage will vary by 20 percent. With a range between 400,000 (bbls/d) and 600,000 (bbls/d), the royalty percentage will vary between 20 percent and 25 percent. With a range over 600,000 (bbls/d), the royalty percentage will be 25 percent. 619 del 2000.

<sup>67</sup> CONSTITUCIÓN POLÍTICA DE COLOMBIA art. 360. Article 289 of the Colombian Constitution politically divides the territory into departments and municipalities. A department is similar to a state in the United States, and a municipality similar to a county. CONSTITUCIÓN POLÍTICA DE COLOMBIA art. 289.

<sup>68</sup> CONSTITUCIÓN POLÍTICA DE COLOMBIA art. 361. Article 361 states that a national fund, using the royalties not distributed to departments and municipalities, must be created to finance social projects in the rest of the territorial entities where hydrocarbon production does not take place. Congress Law 141 of 1994 further implements this article. *Law No. 141, Jun. 30, 1994, [41.414] Diario Oficial, 1.*

<sup>69</sup> There are other local taxes.

<sup>70</sup> Decree No. 624, mar. 28, 1989, [38.756] *Diario Oficial, 1.* The base for this tax is calculated by subtracting operation costs, financial costs and depreciation of fixed assets from the gross income.

<sup>71</sup> Decree No. 624, mar. 28, 1989, [38.756] *Diario Oficial, 1.*

<sup>72</sup> Law 383 1997 Decree No. 624, Mar. 28, 1989, [38.756] *Diario Oficial, 1.*

<sup>73</sup> Decree No. 2140, Aug. 25, 1995, [28.835] *Diario Oficial, 1.* For oil transported from the eastern part of the country this tax is two percent. Decree No. 2140, Aug. 25, 1995, [28.835] *Diario Oficial, 1.*

<sup>74</sup> Decree No. 624, mar. 28, 1989, [38.756] *Diario Oficial, 1.*

<sup>75</sup> Law 633, 2000.

tory for all persons having assets approximately over \$100,000 dollars, was created by Law Number 345 of 1996.<sup>76</sup> It provides that a one-time contribution of .5% of the value of the total liquid assets has to be made through the purchase of war bonds, which accrue interest at 80% of the yearly inflation.<sup>77</sup> Taxpayers can use these bonds can use to pay other taxes.

## VI. ENVIRONMENTAL AND ETHNIC PROTECTION REQUIREMENTS

Law 99 of 1993 is the basic Colombian environmental law. This law requires that all exploitation of natural resources must have the lowest possible impact on the environment.<sup>78</sup> The associate company needs to obtain a license after submitting a plan for environmental conservation and rehabilitation to the Ministry of Environment.<sup>79</sup> This process takes anywhere between six months to one year.<sup>80</sup> Other requirements, which reflect the public policy adopted several years ago to protect the nation's identity and cultural heritage, can make this time period longer. Specifically, article 330 of the Colombian constitution mandates the exploitation of natural resources in Indian territories to be carried out without undermining their social, economic and cultural soundness.<sup>81</sup> Furthermore, article 76 of Law 99 of 1993 requires that, prior to extracting natural resources from Indian and African-Colombian territories, the environmental, social, and cultural impact have to be evaluated jointly with members from the communities inhabiting them.<sup>82</sup> Thus, without the consent of these minorities, an associate company cannot exploit oil reserves.<sup>83</sup>

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<sup>76</sup> Law No. 345, Dec. 27, 1996, [42.951] *Diario Oficial*, 6.

<sup>77</sup> Decree 204 of 1997, specified that these bonds were to be bearer bonds. In addition, it specified that the .5 percent excluded investments in stocks, pension, and social security funds. The total amount of bonds issued was 600,000 million pesos, around 5 billion dollars in 1998. Decree No. 204, Jan. 30, 1997, [42.973] *Diario Oficial*, 4.

<sup>78</sup> Law No. 99, Dec. 22, 1993, [41.146] *Diario Oficial*, 1.

<sup>79</sup> Law No. 99, Dec. 22, 1993, [41.146] *Diario Oficial*, 1.

<sup>80</sup> In May 1999 seismic and drilling exploratory activities were exempted from this requirement to reduce the process's length, as part of the government's effort to improve the prospects of investing in Colombia. Decree No. 788 May 7, 1999, [43.574] *Diario Oficial*, 13.

<sup>81</sup> CONSTITUCIÓN POLÍTICA DE COLOMBIA, art. 330.

<sup>82</sup> Law No. 99, Dec. 22, 1993, [41.146] *Diario Oficial*, 1. Law 21 of 1991 further extends this evaluation to consider the spiritual impact extraction of natural resources may have on Indian Communities. Law No. 21, Mar. 4, 1991, [39.720] *Diario Oficial*, 1. The environment plays a central role in the moral and ethical beliefs of the Colombian Indians, who perceive themselves as part of their natural surroundings. Thus, they regard someone extracting resources from the earth, for example, as draining life directly from them, *Robert La Batte Woableza. Dakota Story Teller*, at <http://www.starhawk.com/uwa/> (last visited July 2001).

<sup>83</sup> Law No. 99, Dec. 22, 1993, [41.146] *Diario Oficial*, 1. A Special Technical Commission composed by members from three different government agencies; the Colombian Institute of Agrarian Reform, the Colombian Institute of Geography, and the Ministry of

The foregoing provision's requirements are difficult to meet due in part to historically existent tensions between these groups and dominating majorities which come up and entangle the negotiations prior to obtaining an approval to extract the reserves.<sup>84</sup> This increases the company's costs and the operation's risk since, even though chances of obtaining the approval are high, it might take a considerable amount of time to do so.

## VII. CONCLUSION

In geological terms, Colombia's attractiveness is high. Recent efforts to modify transactional, environmental and tax aspects of the nation's oil policy have substantially reduced the government's take,<sup>85</sup> which is comparatively low. Nevertheless, the policy's social complexity, together with the narrow window for negotiation it provides, the lack of an efficient alternative dispute resolution mechanism, the impossibility of assigning them and their vague terms pertaining to events of default and indemnification by Ecopetrol, materially affect the prospect of exploiting Colombian reserves.

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Environment, verifies that these territories are in effect occupied by Indian and African-Colombian communities. It also intermediates between the communities and the companies. *Law No. 70, Aug. 27, 1993, [41.013] Diario Oficial, 1*. For further information on how this commission operates, see Decree No. 1745, Oct. 12, 1995, [42.049] *Diario Oficial, 1*. Decree No. 1320, Jul. 13, 1998, [43.340] *Diario Oficial, 2* regulates approval by Indian and African-Colombian communities.

<sup>84</sup> In 1998 Ecopetrol re-negotiated contractual terms with Occidental in exchange for its agreement to give up its rights in the Samore block where U-wa Indians opposing oil development had threatened to commit massive suicide, at <http://www.starhawk.com/uwa/> (last visited in July 2001). The U-wa tribe found the deed dated 1661 which accredits that title to the land had been granted to them by the Spanish Crown. *Occidental Petroleum contra el Pueblo U-wa*, at <http://www.geocities.com/asouwa/>, these property rights had to be respected by the government.

<sup>85</sup> This consists of the production share received, the taxes paid by the associates, and the royalties received by territorial entities from 85 percent to 65 percent. See *La Nueva Política Petrolera*, paragraph 13, *Publicaciones*, at <http://www.ecopetrol.com.co/prin/not.htm> (last visited Jul.-Aug. 1999).