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Financial mechanisms to manage Ecuador's deficit

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At the end of May 2010, the Ecuadorian Institute of Social Security (IESS, for its acronym in Spanish) decided to invest \$550 million in sovereign bonds of the Ecuadorian government. Leaders of the private sector expressed their disagreement with that decision. For them the IESS should not be financing the government as long as it maintains an outstanding debt with that institution.

The President of the IESS Technical Investment Committee countered these criticisms saying that the decision to purchase government bonds through the stock markets of both Quito and Guayaquil, obeys to technical studies which supported the profitability and security of the measure, and that therefore, in the end, the IESS had "taken advantage of an excellent investment opportunity".

Moreover, the official pointed out that the historically the government had always honoured its commitments derived from the bond investments in the domestic market, either with regard to capital or to interests, and that the \$550 million investment in government bonds over a 10 to 12-year term would give the IESS more than \$835 million in interests – a sum that would guarantee IESS services to its affiliates in terms of medical care and pensions.

It is important to note that in the current month of August, the IESS decided to make a new investment in government bonds; this time for \$492 million.

It is understandable that the central government, in order to solve the recurrent gaps in the fiscal budget, should turn to the country's most important institutional investor for financing. It would be unjustifiable and censurable, though, if those investments arose from the central government's imposition, or

if they had been agreed upon in financial conditions inferior to other conditions of a similar nature.

Beyond the economic situation, however, it is clear that the national government is feverishly seeking sources of financing which would enable it to entirely and timely attend the exuberant public spending which, according to some analysts, represents the current government's Achilles' heel.

Within this context, throughout the last months, the national government has sponsored several bills to amend both the Law on Monetary Regime and State Bank (LRMBE, for its initials in Spanish) and the Hydrocarbon Law. According to overall opinion, such amendments would give to the central government access to important financial resources. The proposed bills have had followed different paths in the National Assembly.

Indeed, halfway through July, the amendment to the LRMBE was proposed for a second debate in the Assembly. The aim of said amendment was to modify the intervention framework of the Central Bank of Ecuador (BCE, for its initials in Spanish) and the structure of its General Balance Sheet, which since the year 2000 comprises four systems to maintain a separate and independent accountability.

However, since December, 2008, the BCE balance sheet "failed to square", due to the fact that government decided to liquidate, at no charge, the bonds issued to confront the crisis of the financial system during the years 1999 and 2000, and on the list of BCE assets. This decision prevented the BCE from squaring its balance because it meant that the BCE had incurred in a huge loss.

In the amendment draft sent to the Assembly two of the four systems were eliminated. The purpose was to enable the BCE to square its balance sheet and to gain access to resources alien to it, fundamentally public sector deposits, in order to commit them in medium and long-term investments. Despite

its commanding majority in the Assembly, the government did not have the necessary support. Notwithstanding the foregoing, the President of the BCE Board of Directors has not yet ruled out the presentation of a new legislation, perhaps a whole new law and not just an amendment to the current LRMBE. In any case, it is expected that any change in the law will prioritize economic stability rather than the liquidity problems of the current government.

The other amendment promoted by the Executive, however, has indeed been approved by the National Assembly, in the midst of a process that was severely questioned by the political sectors of the opposition.

On June 24 2010, the President sent the bill of Amendment of the Hydrocarbon Law to the National Assembly, as an urgent issue in economic matters. Pursuant to article 140 of the Constitution of the Republic of Ecuador, the National Assembly had a thirty-day deadline to approve, modify or reject said bill. Under the Constitution if the bill is not discussed during this period the bill becomes law by the inaction of the deputies. The amendment to the Hydrocarbon Law was eventually published in the Official Register, supplement number 244, dated July 27 2010.

The amendment provided the creation of two new entities in the oil sector: the Agency of Hydrocarbon Regulation and Control (Agencia de Regulación y Control Hidrocarburífico) and the Hydrocarbon Undersecretariat (Subsecretaría de Hidrocarburos). The former takes over the current functions of the National Hydrocarbon Directorate (Dirección Nacional de Hidrocarburos) and will be an entity of public law, attached to the Ministry of Non-renewable Natural Resources (Ministerio de Recursos Naturales no Renovables), which in turn, shall be in charge of supervising the oil sector activities and of sanctioning violations of the provisions of the Hydrocarbon Law and the oil contracts. The other State department, i.e. the Hydrocarbon

Undersecretariat, shall be attached to the Ministry itself and shall fulfil certain functions that were Petroecuador's responsibility, in other words, the administration of oil reserves and the subscription of oil contracts on behalf of the Ecuadorian Government.

The amendments also provide the change of the contract model that has been used for activities of oil exploration and exploitation, with the purpose of returning the ownership of the whole national production to the government, by imposing on the contractor a tariff per produced barrel, which does not fluctuate depending on the oil price. Indeed, within a term between 120 and 180 days, contractors and government shall re-negotiate the current oil participation contracts, and move on to the new model contract of Services Rendered.

Despite the fact that the tax authorities have been cautious when quantifying the consequences of the amendment, consequences which can only be estimated after concluding the term of contract renegotiation, it is evident that amendment is aimed on liberating important resources for the Ecuadorian Government which, hopefully, will serve to secure the sustainability of our economy in the long run, and not only to cover the deficit of the budget.

Financial and corporate

Recommended firms	
Tier 1	Bustamante & Bustamante Pérez Bustamante & Ponce
Tier 2	Coronel & Pérez Quevedo & Ponce Romero Arteta Ponce
Tier 3	Corral-Sánchez Paz Horowitz Zavala Baquerizo Abogados

On the announcement of a new hydrocarbons regime, Ecuadorian officials were already warning international developers they would not be interested in entering the nation's oil industry anytime soon. Ecuador's legal community sees the legislation as just another way President Rafael Correa is alienating important private investors. "The left-wing administration does not concur with the idea of free market," says one leading lawyer, "and private enterprise has taken its toll."

Lawyers say the government is more interested in having players in the private market rather than all-out nationalisation of whole industries. "The government is creating companies for everything," one lawyer says, citing state-owned businesses in everything from cellular services to cement. The effect is one of attrition; private players cannot sustain growth in an environment slanted to favour a government entity.

The president continues his erratic, contradictory foreign policy in regard to neighbouring countries. In August 2009, Ecuador formally withdrew from the International Centre for the Settlement of Investment Disputes (Icsid), and moved to terminate 13 bilateral investment agreements including those with the US and the European Union.

But last June the country signalled interest in rejoining talks with Andean nations and the EU to re-establish trade relations. Similarly, the president used a recently published truth commission to condemn Alan García for human rights violations while signing an \$800 million agreement with Petroperu to send excess oil to the southern neighbour.

Market feedback sees a continual decline in commercial transactional work and a growing emphasis on wholesale litigation work and tax advice. The biggest news in Ecuador's legal community is the passage of significant tax reforms at the end of 2009. New provisions include a new value-added tax, doubling of the tax on foreign remittances and increased tax on dividends to companies in low and tax-free jurisdictions. "This is a major event for our economy," one lawyer notes, adding: "There is a very serious deficit in our national budget and it doesn't seem clear that that has been covered by any means."

The government has been unable to find underwriters for a much-needed international bond, and commentators mention overtures from China for a \$1 billion loan to finance an issuance never materialised last year. Instead the government has resorted to selling bonds locally, creating what one competitor describes as a "revolving door of finance" from local banks and pension funds that buy the debt.

Bustamante & Bustamante

One commentator notes of Bustamante: "Some of their more talented young attorneys have been leaving." The Ecuadorian legal market became recently dynamic when partner Jorge Pizarro left with a team of mid-level lawyers to start a rival operation. Market feedback says the spinoff was not amicable, but Bustamante is strong enough to suffer the

loss. "They have hired some young attorneys," says one peer.

Last year the firm formed a strategic alliance with the Alvear Law Firm, a litigation boutique in Guayaquil managed by partner José Alvear. The association gives Bustamante a stronger presence in Ecuador's second city.

Competitors acknowledge partner José Rafael Bustamante manages the firm's administration, as well as its clients and professional associates. One foreign attorney who recently worked with Bustamante was impressed by his ability to adapt foreign structures to Ecuadorian law. "He was very good at putting a commercial legal issue within local context," says the lawyer.

The firm has advised the development of Quito's new international airport, including offering opinions on the legal frameworks for the concession with the government, securities aspects and investors rights.

Leading lawyers

José Rafael Bustamante
Agustin Hurtado
Patricia Ponce

Pérez Bustamante & Ponce

"They have been active in 2009," remarks one competitor of Perez Bustamante & Ponce. The firm's talent is described as "excellent" with senior statesman status given to partner José Rumazo-Arcos. "He is a mature, experienced lawyer," one peer says, "and is probably close to retirement."

While market notes that the firm has seen a recent drop in transactional work, one client commends partner Diego Pérez-Ordoñez for his recent M&A work. "He covers a wide range of matters, including environmental and labor issues," one corporate counsel says, "and has a good sense of all these legal matters in asset and purchase agreements."

One recent area of activity for the firm is establishing distribution agreements for multinational retailers like Rolex and Proctor & Gamble. The firm also counselled bleach brand Clorox in manufacturing contracts with Ecuadorian counterpart La Fabril.

Last year the firm acted locally in the US automotive industry bailout that had worldwide repercussions. Pérez-Ordoñez and Partner Rodrigo Jijón advised General Motors in transferring shares in its Ecuador subsidiaries in favour of the US Treasury and United Auto Workers pension trust.

Leading lawyers

Rodrigo Jijón
Diego Pérez-Ordoñez
José Rumazo-Arcos

Coronel & Pérez

Known as a leader in the city of Guayaquil, Coronel & Pérez is described by competitors as “very solid” with a “good reputation in litigation and corporate issues.” While the firm has an office in the capital, one competitor says the firm “has nothing major going on in Quito.”

Partner Jorge Sicouret Lynch is called a “very good, very thorough and thoughtful” attorney with a background in concession and contract dispute resolution. Rivals consider César Coronel Jones the main force in corporate matters.

Leading lawyers

César Coronel Jones
Jorge Sicouret Lynch

Quevedo & Ponce

Quevedo & Ponce is described by one rival as “a firm that has been losing some punch.” Competitors cite generational issues as a problem for firm. “There are top lawyers at that firm,” one peer notes, “but it has not been able to develop new stars.” Competitors mention partner Alejandro Ponce Martínez for his commercial litigation skills, and note the firm’s “enviable IP practice”.

Leading lawyers

Alejandro Ponce Martínez

Romero Arteta Ponce

Foresight is a valuable commodity in Ecuador these days, and one client says RAP partner Gustavo Romero Ponce has his ear to the rail on the nation’s political front. “The situation is very dynamic,” explains the corporate counsel, “and he keeps me apprised of situations that may come down the line six weeks or two years from now.”

Recently the firm has represented cement producer LaFarge as one of the few multinationals fighting an upstream battle in Ecuador’s industrial market. In 2009 the company inaugurated its Otavalo plant at a cost of \$120 million, doubling its production capacity in the nation.

Leading lawyers

Diego Romero Ponce
Gustavo Romero Ponce

Other ranked firms

Noted as a “very reputed Quito shop”, Corral-Sánchez earns marks for arbitration and constitutional cases. One competitor mentions the firm may be picking up work lately in the telecoms, labour and tax markets. “It’s their

bread and butter,” the lawyer says, “so they’ve been riding the waves.”

Partner Fabián Corral earns praise in the market as “one of the most solid practitioners in the market,” with strong academic credentials as dean of the law department at Quito’s University of San Francisco.

Leading lawyers: Fabián Corral Burbano de Lara

Competitors characterise partner Jorge Paz of Paz Horowitz as a “very good rainmaker” who “may be suffering from a lack of investment in mining and aviation.” Still, rivals commend the “small, solid firm” for its decidedly international flavour. Partner Bruce Horowitz is described as the firm’s link to US clients.

Leading lawyers: Jorge Paz Durini

Zavala Baquerizo Abogados stands as a reputed option in Guayaquil. “They have a very active in criminal and commercial practice for the market,” one competitor remarks.

Market feedback holds partner Eduardo Carmigniani to be a rising force in Ecuador’s legal playing field. “He’s become one of the leading litigators in Ecuador has some banking experience as well,” says one peer.

Leading lawyers: Eduardo Carmigniani