Crude oil tankers anchor near the Ecuadorean port of Esmeraldas.
REUTERS/GARY GRANJA

How Beijing gained control of the oil exports of OPEC member Ecuador

China's power play in America's backyard

BY JOSHUA SCHNEYER AND NICOLAS MEDINA MORA PEREZ

NEW YORK, NOVEMBER 26, 2013

BIG: Chinese state-run firms such as PetroChina are allocated 83% of Ecuador's crude exports.
REUTERS/KIM KYUNG HOON

China's aggressive quest for foreign oil has reached a new milestone, according to records reviewed by Reuters: near monopoly control of crude exports from an OPEC nation, Ecuador.

Last November, Marco Calvopiña, the general manager of Ecuador's state oil company PetroEcuador, was dispatched to China to help secure $2 billion in financing for his government. Negotiations, which included committing to sell millions of barrels of Ecuador's oil to Chinese state-run firms through 2020, dragged on for days. Calvopiña grew anxious and threatened to leave.

"If the Phase III transaction documents are not signed in the coming days, then I cannot remain in Beijing," he wrote in a confidential letter to China Development Bank (CDB), reviewed by Reuters.

In reality, Calvopiña had little choice but to wait. Shunned by most lenders since a $3.2 billion debt default in 2008, Ecuador now relies heavily on Chinese funds, which are expected to cover 61 percent of the government's $6.2 billion in financing needs this year. In return, China can claim as much as 90 percent of Ecuador's oil shipments in coming years, a rare feat in today's diversified oil market.

"This is a huge and dramatic shift," said Rene Ortiz, a former Ecuadorean energy minister and secretary general of the Organization of the Petroleum Exporting Countries. "Never before has Ecuador committed its oil to a lender."

A small OPEC exporter, Ecuador pumps around 520,000 barrels per day (bpd), or 5 percent as much oil as kingpin Saudi Arabia. But China's role in the Andean country shows how the Asian giant's oil firms are becoming powerhouse traders in energy markets far from home. The oil that Ecuador sells to Chinese firms can be traded anywhere. Yet less than 15,000 bpd is being shipped to China this year, down nearly 40 percent from 2012. Most is sent to the United States.

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>
> **Rene Ortiz**
> former minister of energy

President Rafael Correa, a socialist who is critical of the power that Western oil majors and private energy trading firms once held in Ecuador, has touted the Chinese deals as a triumph of trade between close allies. Ortiz and other critics say the cash-strapped government's dependence on loans with increasingly onerous terms could hurt PetroEcuador's competitiveness, damage transparency in an oil industry that accounts for half of Ecuador's exports, and distance the country from other creditors.

Contracts, company presentations, and crude loading schedules show how China has come to dominate trading of Ecuador's 360,000 bpd of oil exports since its biggest listed oil company, PetroChina, first offered PetroEcuador $1 billion in financing in mid-2009.

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By April of 2010, Chinese firms were receiving around a third of Ecuador's export oil. A year later the volumes had nearly doubled. By mid-2013, Chinese state-controlled firms were allocated 83 percent of Ecuador's oil exports.

When the latest loan deal was made public, in August, it brought the amount of financing that China has pledged to Ecuador during Correa's presidency to nearly $9 billion – equivalent to 11 percent of Ecuador's gross domestic product.

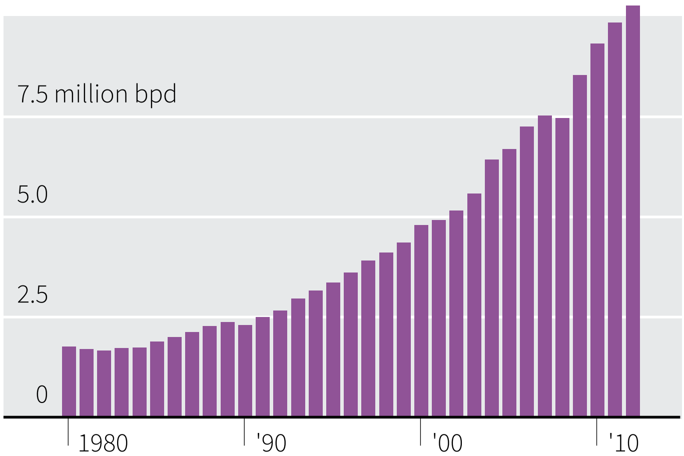
About 60 percent of these oil shipments are handled by PetroChina, the world's second-largest publicly traded oil firm after ExxonMobil and the listed arm of state-owned parent China National Petroleum Corp (CNPC). State-run Unipec – the trading unit for giant Sinopec Corp – and other Chinese firms get smaller volumes, the schedules show.

Beijing's growing thirst for natural resources has led Chinese oil firms to offer at least $100 billion in oil-related financing around the world. They already control

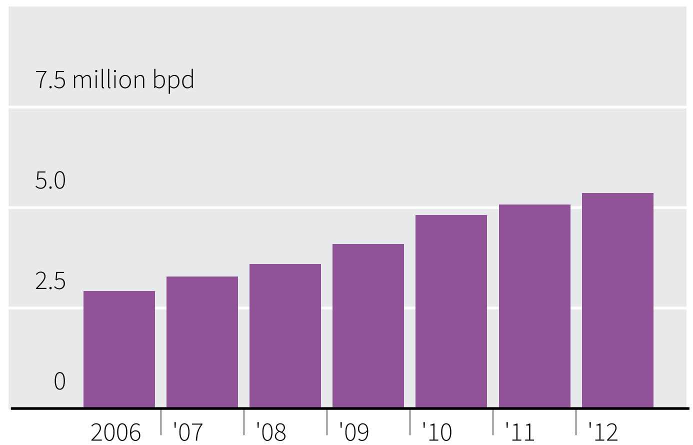
Great thirst

As China's oil use soars, Beijing is forging close ties to Ecuador and other exporters

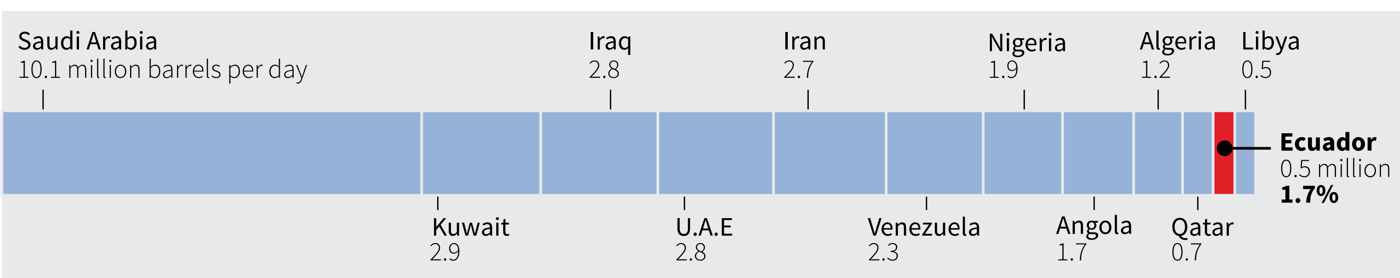
CHINESE OIL CONSUMPTION



CHINESE CRUDE OIL IMPORTS



OPEC DAILY OIL PRODUCTION



Source: Chinese customs (imports); U.S. Energy Information Administration (China consumption); The Organization of the Petroleum Exporting Countries (OPEC)

growing volumes of oil from Venezuela, where China has negotiated at least $43 billion in loans; from Russia, where the tab may exceed $55 billion; and Brazil, with at least $10 billion. In Angola, the deals total around $13 billion.

In Ecuador, Chinese firms also participate in oil fields and a refinery project. But most of the loan transactions don't hand China direct control of oil wells, reservoirs or pipelines. Instead, the borrowings are repaid with cash proceeds from PetroEcuador's oil sales to Chinese firms.

The Chinese "provide financing for our country and, in exchange, we ensure sales of oil at international prices," Ecuador's then-Finance Minister, Patricio Rivera, told state-run TV earlier this year.

PetroChina International told Reuters its arrangements in Ecuador "are purely normal commercial contracts between two companies," and "have proved to be mutually beneficial."

PetroChina declined to discuss their terms. A PetroEcuador spokeswoman declined to comment; President Correa's office did not respond to questions from Reuters.

BEIJING-BACKED TRADERS

China's cash advances to Ecuador cover only a slice of the near $13 billion a year Ecuador can earn from oil sales. But since 2009 PetroEcuador has agreed to sell Chinese firms several hundred million barrels of oil, valued far higher than the loans themselves, according to a Reuters analysis of seven different contracts. With those supplies locked up, other buyers now get few chances to purchase crude from PetroEcuador in competitive tenders.

Today, Ecuador sets aside as little as 10 percent of its export oil to sell in such tenders to the highest bidder, Calvopiña told state TV earlier this year. In the past, tenders were far more common and frequented by U.S. oil majors or European trading firms. In one of just three such open tenders

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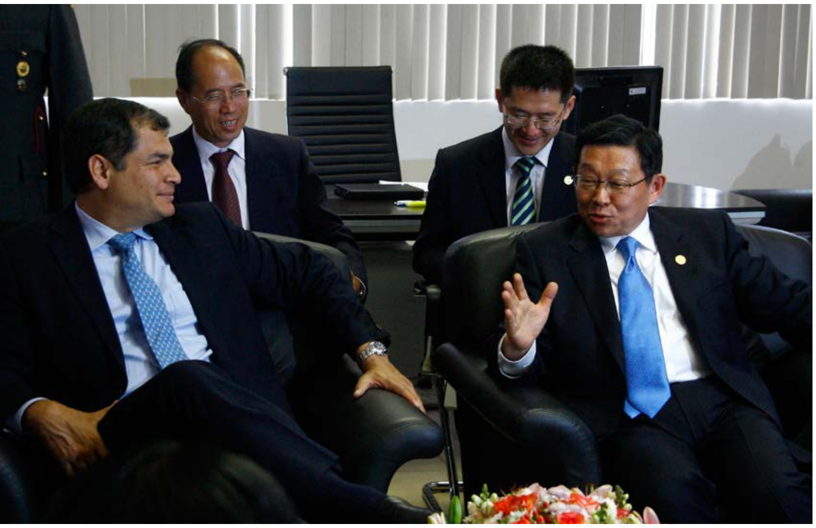
COMMERCIAL CALCULUS: China has lent billions to Ecuador against future oil exports. Top, an exploration rig at the Cuyabeno reserve. Bottom left, President Rafael Correa with Chinese Commerce Minister Chen Deming. Bottom right, Esmeraldas is a major export outlet. **REUTERS/GUILLERMO GRANJA, ERICK ILAQUIZE, GUILLERMO GRANJA**



announced this year, Spain's Repsol bought 4.3 million barrels in September.

Chinese drillers have long competed with oil majors like Exxon. Since 2009, they have spent some $100 billion to buy oil and gas fields, in Latin America and elsewhere. Earlier this month, PetroChina and its parent company, CNPC, agreed to buy stakes in three Peruvian oil and gas fields for $2.6 billion.

But experts say the Chinese firms' strategy is evolving: By gaining control of crude flows from other national oil companies, China's oil giants are expanding into oil trading, where they compete with big commodity houses like Trafigura and Glencore.

"This is part of the increase in sophistication in Chinese companies," said Chen Ziwhu, a Yale finance professor and China specialist. With oil-backed loans, "Chinese companies are moving away from buying oil fields and wells."

The new oil flows allow China to hedge its exposure to oil prices or disruptions from suppliers closer to home, including top OPEC producers Saudi Arabia, Iran and Iraq.

Although China's oil imports are rising – they reached around 6.3 million bpd in September – several of its state oil firms now trade more oil abroad than they import to China, an official told Reuters last month.

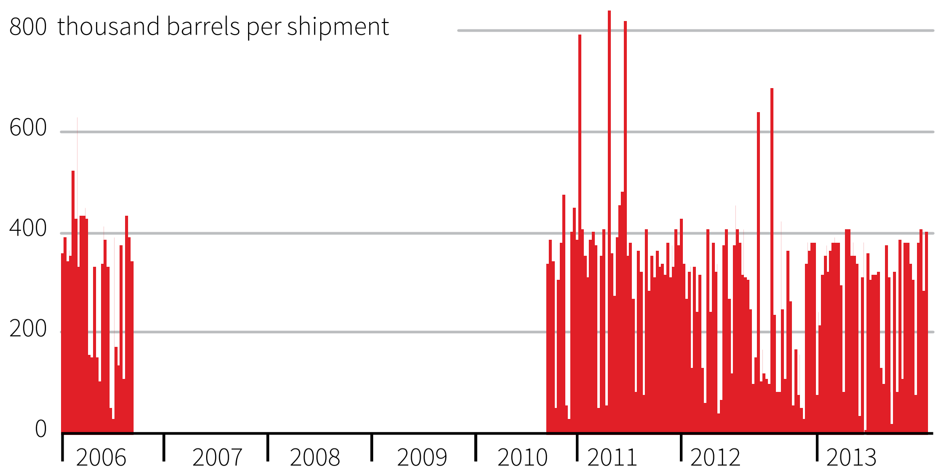
Less than 2 percent of Ecuador's oil was shipped to China during the second quarter, according to Ecuadorean Central Bank data. Instead, at least 214,000 bpd of it wound up in the United States, where many refineries are configured to process heavy-sour Latin American crude.

Chinese firms serve as middleman in most of the Ecuadorean oil sales, while keeping a strategic option to divert barrels to China if needed. As China's trade grows in the region, U.S. relations have soured with Venezuela and Ecuador, whose leaders are outspoken U.S. critics.

"If China's control over South America's oil industry keeps growing, it could become a concern for U.S. policymakers," said Riordan Roett, political science professor at Johns Hopkins School of Advanced International Studies in Washington.

Big player

Taurus Petroleum oil imports into California



Source: PIERS data based on U.S. Customs reports

GROWING LEVERAGE

An analysis of hundreds of pages of Ecuadorean documents, including internal PetroEcuador memos, presentations and crude lifting schedules, offers new details on how China came to dominate Ecuador's oil flows.

Shortly after taking office in 2007, Correa, a U.S.-trained economist, declared a large chunk of Ecuador's foreign debt "illegitimate" and "odious," and the country defaulted the next year. With Ecuador considered a pariah in credit markets and the government scrambling to balance the budget, PetroChina offered a lifeline in July of 2009, depositing $1 billion in Ecuador's coffers. The "pre-finance" deal was to be repaid over 2 years and carried a 7.25 percent interest rate. Ecuador committed 96,000 barrels per day to Chinese firms.

Initially, PetroChina also agreed not to sell Ecuador's oil in nearby markets such as Peru or Chile, considered "PetroEcuador's natural market." For competitive reasons, many OPEC state oil companies retain tight control over the destination of their crude. In a July 2009 memo, Ecuador's Finance Ministry advised against giving China permission to resell Ecuador's crude wherever it pleased.

As the loans began flowing in, Chinese firms also seemed to be gaining favor in Ecuador.

In 2009, Correa was drawing praise from environmentalists with a plan to keep Ishpingo-Tambococha-Tuputini, or ITT – an oil-rich area of Ecuador's pristine Yasuni National Park – untouched by drilling. To do so, he publicly sought pledges of $3.6 billion from rich nations to fund the effort.

But the same year, Ecuador's economic policy ministry drew up a private presentation for Correa's staff, reviewed by Reuters, in which they pledged to "make the utmost effort to support PetroChina and Andes Petroleum," another Chinese-controlled driller, "in the exploration of the ITT" oil field.

Correa scrapped the Yasuni initiative this August, citing insufficient funding, and signaling that drilling could proceed in a small area of ITT. Petroamazonas, a state-run PetroEcuador affiliate, is expected to drill there, Correa says. Whether Ecuador will enlist a foreign partner remains unclear.

After 2009, terms changed in new Chinese loans, documents show. A 2010 deal for another $1 billion credit line from China Development Bank cut the premium that PetroChina would pay for Ecuador's oil, and granted PetroChina approval to resell the crude in any market.

In early 2011, Ecuador got another $1 billion loan, and authorized PetroChina to collect money from any other companies that owed PetroEcuador if Ecuador failed to meet repayment terms.

DEBTOR'S REMORSE?

PetroEcuador has sometimes been wary of the deals. In a March 2011 presentation, it cautioned that PetroChina's claim on Ecuador's oil flows might prevent it from selling to buyers willing to pay more. Market factors were converging to make Ecuadorean oil more "competitive," it said, suggesting fewer barrels be committed to PetroChina. The advice went unheeded.

PetroChina also has partnered with private trading firms – including one, Swiss-based Taurus Petroleum, whose trading in Iraqi oil had drawn scrutiny from U.S. prosecutors in the past – to resell some of Ecuador's oil.

For now, PetroEcuador's ability to seek other customers appears limited. An internal PetroEcuador memo prepared before the China Development Bank offered its latest loan carried a sobering reminder: "The proposed transaction will turn CDB into Ecuador's biggest financial creditor." Chinese loans would now be linked to "the majority of Ecuador's oil revenue over the medium and long-term."

Reporting By Joshua Schneyer and Nicolas Medina Mora in New York. Edited by Jonathan Leff

NEW TUNE: On President Rafael Correa's watch, Taurus Petroleum has emerged as a big middleman. **REUTERS/ FABRIZIO BENSCH**

The traders behind the Ecuadorean oil triangle

Ecuador's Socialist President Rafael Correa has often railed against allowing private trading firms to control the country's oil shipments, a top source of export revenue. Soon after his election in 2006, Correa pledged to cut out middlemen.

But on his watch, the opposite has happened. As the OPEC country committed to selling the bulk of its export crude to Chinese state-owned firms, a little-known Swiss trading house and its business partners have secured a role as intermediaries in the South American country's oil trade.

Internal shipping schedules from state-owned oil firm PetroEcuador show that PetroChina Co Ltd. – the main buyer of Ecuador's crude - engaged a small Hong Kong-based firm named Ursa Shipping Ltd to help ship the oil. Together, they handled around two-thirds of the 33 million barrels of oil Ecuador exported during the second quarter, the schedules indicate. Around 70 percent of their shipments were sent to the United States directly or to PanPac, an area offshore Panama where oil cargoes are often loaded onto U.S.-bound vessels.

Market sources say Ursa acts as a shipper for Geneva-based oil trading firm Taurus Petroleum, whose mainstay business a decade ago was selling Iraqi crude under U.N.'s oil-for-food program. For the past four years, Taurus has played a key role selling Ecuador's oil along the U.S. West Coast. According to a Reuters analysis of U.S. oil import data gathered by port intelligence group PIERS, Taurus's shipments accounted for nearly 10 percent of California's oil imports in the first nine months of 2013.

Much of the Ecuadorean oil Taurus sold in California arrived via Panama, where ships laden with crude allocated to PetroChina and Ursa have sometimes transferred their loads into other tankers, according to Reuters tanker-tracking data.

In total, Ecuadorean oil – largely handled by PetroChina's private trading partners – makes up 17 percent of the U.S. West Coast region's 1 million bpd crude imports this year. Only Saudi Arabia and Canada supply more.

It is perfectly legal for PetroChina, the world's No. 2 publicly-traded oil firm, to enlist traders to market Ecuador's

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The mystery traders of Ecuador's crude

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crude, little of which is shipped to China. PetroChina buys Ecuador's crude under long-term contracts that provide up-front Chinese funding for cash-strapped Ecuador.

But the role of private entities is a potential political issue in Ecuador. Under Correa, well-known trading firms such as Glencore Xstrata, which had previously bought large volumes of Ecuador's crude, haven't been allowed to purchase PetroEcuador's oil. Instead, Correa has touted Ecuadorean oil sales to China as a triumph of trade between friendly governments.

A U.S.-based spokesman for PetroChina said all of its business with PetroEcuador is "within the boundaries of applicable laws and corporate policies." The firm declined to comment on any relationships with trading firms. A spokeswoman for PetroEcuador declined comment. President Correa's office didn't respond to questions from reporters.

Taurus, incorporated in 1993, declined to discuss its business or to make its founder, Benjamin Pollner, available for an interview. "We are a private company," said Tancrede Baron, Taurus's finance director, by phone from Geneva in late August. "Our business is confidential." Calls to Ursa weren't returned.

CALIFORNIA-BOUND

Valued at around $6 million per day, Taurus's shipments of oil to California earlier this year were sold to customers including Chevron, which Correa has declared "an enemy" of Ecuador. Chevron declined comment on the purchases.

The California oil giant is locked in a massive lawsuit with Ecuadorean plaintiffs over previous decades of alleged pollution by Texaco, which Chevron bought in 2001.

This month, Ecuador's supreme court upheld a lower court verdict against Chevron, ordering it to pay $9.5 billion.

Correa has in the past decried private oil traders as "corrupt" middlemen who profit at PetroEcuador's expense.

"We are done with intermediaries for our crude," he said in a speech after his 2006 election. Later, in 2008, he touted a direct contract for fuel supplies between PetroEcuador and PDVSA, Venezuela's state oil firm, as cutting out middlemen. Nevertheless, PDVSA later enlisted traders including Glencore to procure the fuel supplies.

Some Ecuadorean opposition figures, including a leftist congressman, Clever Jimenez, have criticized the government and PetroEcuador for allowing PetroChina to farm out business to traders. Detractors say traders are able to sell Ecuador's crude at a big mark-up abroad, which could imply lost revenue for PetroEcuador.

Correa has said Ecuador receives a fair price from PetroChina.

What Chinese firms do with the oil after they take ownership of it in Ecuador isn't PetroEcuador's concern, the company's international trading manager, Nilsen Arias, told Reuters by phone. "The destination is at their liberty," Arias said. He declined to comment on PetroChina's trading.

Taurus has been in the spotlight before. A 2005 report by former U.S. Federal Reserve chairman Paul Volcker identified Taurus and other Pollner-affiliated firms as having bankrolled $18.9 million in illicit payments to win Iraqi oil cargoes during Iraq's U.N.-controlled oil-for-food program. No charges were brought against Taurus or the other Pollner firms. Taurus denied any wrongdoing.

INTER-CONNECTED TRADERS

During most of 2006, Taurus imported around 105,000 barrels per day into the United States, including 54,500 bpd from Ecuador. Its shipments then stopped, the PIERS data shows, resuming in mid-2010 as PetroChina's role in Ecuador grew.

Ecuador's decision to let PetroChina trade its crude freely contrasts with the policies of Saudi Arabia, Venezuela and several other OPEC countries that rarely allow buyers to resell their oil.

In recent months, another company appears to have supplanted Taurus as a key supplier of Ecuadorean crude to California, for reasons unknown. The PIERS data, based on individual bills of lading, shows Taurus's last shipment to California arrived at a Chevron refinery on September 26.

Three days later, New Jersey-based oil trading and logistics firm Core Petroleum began selling Ecuadorean crude into California. Several traders who deal in Latin American oil told Reuters that Taurus and Ursa work with Core Petroleum, established in 2009.

Core Petroleum's website lists Tancrede Baron - the Taurus finance director - as its chief financial officer. A Core employee in New Jersey said Baron was in Geneva and unavailable to talk. Baron didn't respond to emails seeking comment about his role at Core.

Both Taurus founder Ben Pollner and Core's CEO, William Sudhaus, were executives of a former Taurus affiliate, Castor Petroleum, corporate documents show. Castor was acquired in 2009 by a larger Swiss trading firm. Sudhaus didn't return phone calls seeking comment.

Reporting By Joshua Schneyer and Nicolas Medina Mora Perez in New York.

FOR MORE INFORMATION
Joshua Schneyer
joshua.schneyer@thomsonreuters.com
Jonathan Leff, Editor in charge, commodities
jonathan.leff@thomsonreuters.com