



THE RISKS OF INVESTING IN
PETROPERÚ





Maranon River, Peru.

THE RISKS OF INVESTING IN **PETROPERÚ**

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Top cover image: Marañón River, Peru.

Bottom cover image: Barrels containing toxic chemicals at an oil spill site in the northern Peruvian Amazon in 2013. Petroperú, the company responsible for the spill, hired dozens of local Indigenous people in an attempt to make the evidence of the spill quickly disappear. The workers were given little or no protection, exposed to contamination, and asked to use toxic dispersants.

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Marañón River, Peru.



The edge of Cuninico, a Kukama Indigenous community as seen from the Marañón River in the northern Peruvian Amazon. In just a span of six months in 2013, five oil spills resulted from breaks in Petroperú's North Peruvian pipeline, contaminating local villages and threatening their livelihood.

Petróleos del Perú - Petroperú S.A. is a state-owned oil company that has been operating in the **midstream** and **downstream** business. The North Peruvian Pipeline – administered by Petroperú – transports crude oil from the Peruvian Amazon to the coast. Petroperú also refines crude oil in three refineries. The principal refinery Talara is finalizing a modernization project, which plunged Petroperú into debt. Recently, Petroperú returned to the **upstream** business, operating Block I, located on the North Peruvian coast, and the company is seeking to operate other blocks, including Block 64, located in the Peruvian Amazon, which faces community opposition.

The following Risk Alert will describe the political, social, financial, environmental, and legal risks associated with investing in Petroperú. It also compiles the perspective of some communities that could be affected by the threat of oil operations by Petroperú, in particular, the Achuar People of the Pastaza River and the Autonomous Territorial Government of the Wampis Nation. As will be further explained in detail below, Petroperú is known to be a poorly managed company that has seen significant community opposition and social conflicts due to the large environmental liabilities its oil operations have caused. Those factors have put the state oil company in a financial crisis that puts any investor at risk by investing in the company.

POLITICAL RISK

Petroperú's high-level executives are politically appointed. This situation represents a risk for investors because Petroperú's corporate governance and administration depend on the government in power. Allegations have often been made involving the misuse of resources and corporate relationships involving officials accused of or investigated for corruption.

In fact, Petroperú has a history of corruption scandals and crises due to the mismanagement by these high-level executives. The government of current Peruvian president Pedro Castillo has been no exception. Over the past months, Petroperú has entered into a crisis precipitated by corruption scandal involving President Castillo, the President of the Board of Directors, and the Chief Executive Officer, which catalyzed the departure of key high-level executive managers and the financial collapse of the company.

SOCIAL RISK

The oil industry dynamic in Peru is complex and in the case of Petroperú even more so. The North Peruvian Pipeline constantly leaks, which has caused innumerable environmental damages. This situation has led to tense relationships with the Indigenous communities opposed to oil drilling on their land who are forced to live alongside the pipeline. The communities actively protest and seek legal action, creating stoppages and a never-ending barrage of claims against the company.

Indigenous communities impacted by the possible exploration of Block 64 – the Achuar People of the Pastaza River and the Autonomous Territorial Government of the Wampis Nation – which Petroperú is seeking to operate soon, see the company as a harmful operator that will cause similar environmental impacts as those associated with the North Peruvian Pipeline.

National and International demonstrations of community opposition to oil activities in Block 64.

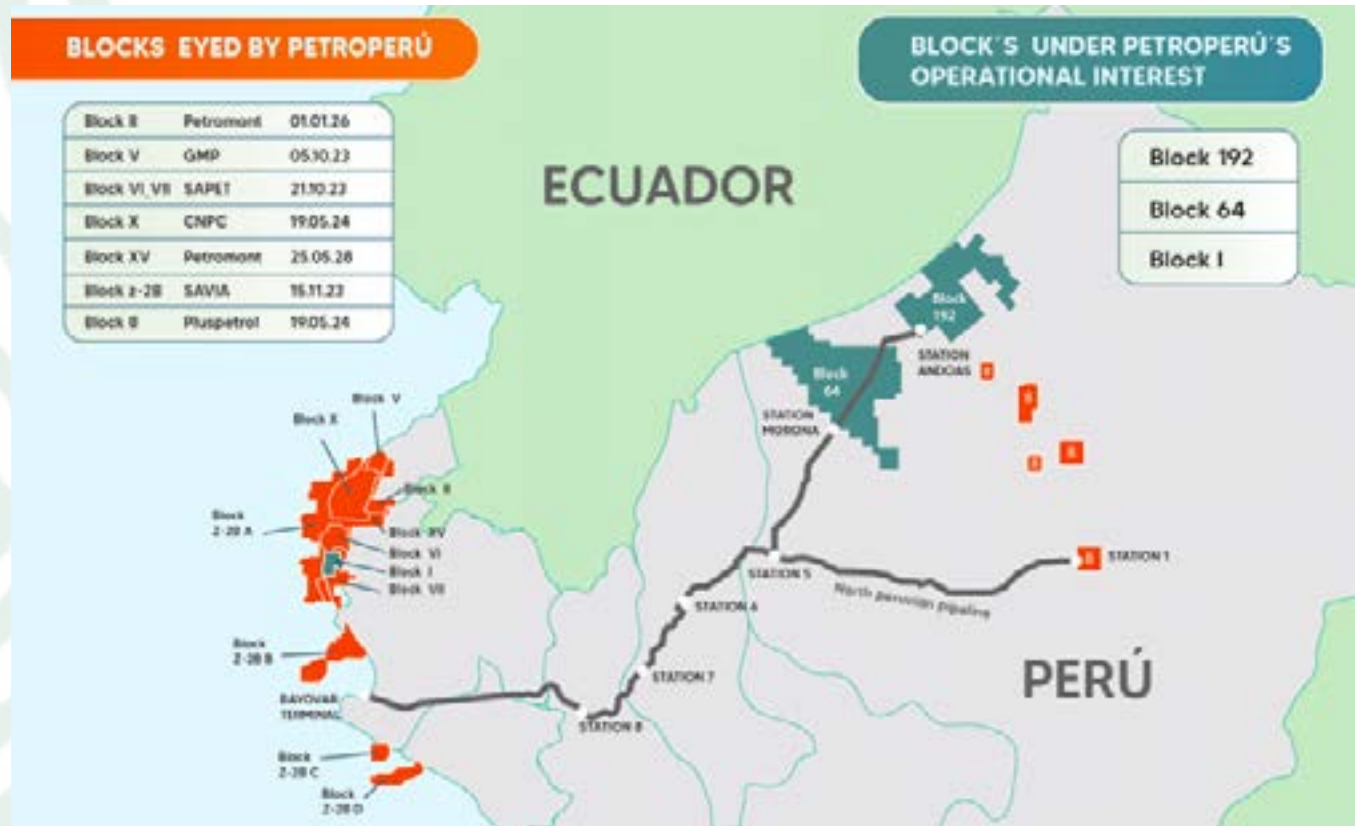


Steady community opposition to oil drilling within Block 64

On the other hand, communities impacted by operations in Block 192 have accepted oil operations after years of complex negotiations over liability remediation, health care, basic services, and damage compensation. Their expectation is that the Peruvian State will remedy the environmental liabilities left by the previous operators. However, remediation is far from being completed since no operator seems to want to be in charge of cleaning up past and costly environmental liabilities. As will be further explained in this Risk Assessment, the former operators of Block 192 had disagreements with the communities and environmental regulators about who should remedy the environmental liabilities left by the previous operator. While currently there is a relative “social license to operate,” or acceptance from impacted communities, if the expectations of communities are not met, there is a risk of new social conflicts within this block.

Currently, the Peruvian government is advocating for other blocks located on the Peruvian coast and the Amazon to be operated by Petroperú, once their respective concession contracts with other private operators end, between 2023 and 2028. All of these future blocks are in a similar situation as Block 192, meaning they have unresolved environmental liabilities without a willingness on the side of current operators to assume these liabilities. Under this situation, Petroperú will be potentially assuming responsibility for the environmental impacts on those blocks. As a consequence, there will be an increase in costs due to the constant community opposition and the expectation of impacted communities to remediate environmental liabilities. This increase in cost could be higher than the potential revenue generated.

Blocks under Petroperú’s temporary operation and of interest to Petroperú along the coast and Amazon.



Petroperú is currently interested in operating 3 oil blocks (those blocks are under Petroperú’s operational interest). Of those blocks only one (Block I) is operational while the two others (Blocks 64 and 192) are suspended. On the other hand, members of the Peruvian Government are advocating for Petroperú to take over some oil blocks located on the Peruvian coast (Blocks, II, V, VI-VII, X, XV, Z-2B) and in the Amazon (Block 8), whose contracts are soon to expire (those blocks are eyed by Petroperú). Source: Amazon Watch based on public information (2022)

GOVERNANCE & FINANCIAL RISK

Petroperú’s mismanagement due to the poor selection of high-level executives has plunged the company into one of its worst financial moments. Petroperú is submerged in a financial hole caused by its over-indebtedness due to the modernization of the Talara Refinery coupled with very little crude oil production. Under the political appointees of President Castillo, Petroperú has shown very little financial transparency, leading to the downgrading of its credit rating by S&P and Fitch. Poor governance and little transparency represent a financial risk for investors.



The rainforest in the Corrientes River basin from the Achuar community of Nueva Jerusalem, right in the middle of Oil Block 1-AB.

According to data from the Bloomberg Terminal, the banks that participated in the financing of Petroperú are JPMorgan Chase, HSBC, Bank of America, Goldman Sachs, Santander, Bank of New York Mellon, Citibank, Deutsche Bank, BBVA, BNP Paribas, Scotiabank, Mizuho Bank, MUFG Bank, Sumitomo Mitsui, and an undisclosed lender. These banks should be aware that by financing Petroperú, they are indirectly impacting Indigenous communities living within or around the blocks where Petroperú intends to operate. These banks should have a due diligence policy and be aware of all the risks involved in investing in Petroperú.

ENVIRONMENTAL RISK

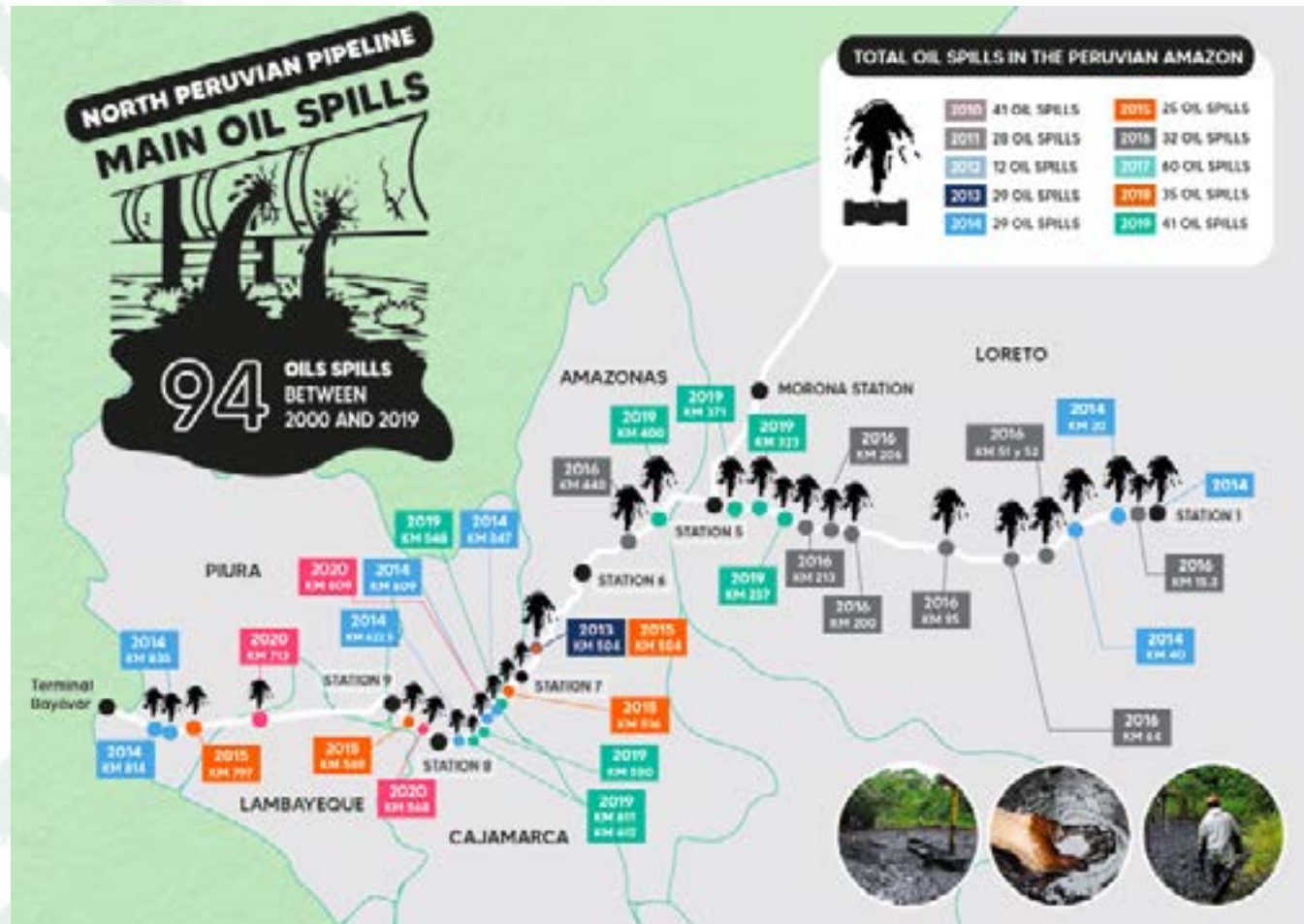
The oil and gas industry is a major source of pollution in the western Amazon. Peruvian institutions and the legal framework for protecting Indigenous rights have been precarious. Under these circumstances, the blocks that Petroperú intends to operate – 192 and 8

located in Datem del Marañón, Loreto – have an unresolved history of contaminations. Since 1997 there have been 422 spills in this region. In the same period on the North Peruvian coast, close to the Talara Refinery, there have been 404 spills. Environmental liabilities and constant contamination are not part of the past and are still a constant problem in the oil industry in Peru.

Environmental emergencies and impacted territories poorly remedied or left unattended have been increasing over the years. Previous operators of those blocks under the interest of Petroperú have not been held responsible for their environmental impacts. Instead, they have started legal processes to avoid assuming their environmental obligations. This situation is present in Blocks 192 and 8, and will probably also occur in the other blocks that Petroperú intends to operate in the future on the North Peruvian coast.

In addition, the operations of Petroperú in the Peruvian Amazon have caused long-term environmental liabilities, affecting the surrounding communities that depend on nature to survive. Mainly, the operation of the old and deteriorated North Peruvian Pipeline caused more than 94 oil spills between 2000 and 2019. Despite this situation, Petroperú continues with operations that have cost the company approximately \$4.3 million dollars just in remediation of environmental liabilities.

North Peruvian Pipeline Oil Spills



Recurring oil spills of the North Peruvian Pipeline (based on the 2016 Final Report of the Peruvian National Congress Investigative Committee to determine the responsibilities for the oil spills that occurred in the North Peruvian Pipeline and the Report The Shadow of Oil by OXFAM)

LEGAL RISK

Petroperú is the third company in Peru with the most administrative sanctions due to environmental liabilities. It is currently involved in eight legal cases that represent approximately \$5 million dollars in economic sanctions. It should be noted that this amount considers only economic sanctions for administrative processes and not all the other costs of remediation and compensations.

Furthermore, Petroperú has announced its willingness to operate Block 8, in the Peruvian Amazon, and other blocks on the North Peruvian Coast, supported by the Peruvian government. Most of these blocks are in a similar legal situation to Block 192, where environmental liabilities exist with previous operators refusing to assume the remediation.

In the case that Petroperú assumes operations on the Peruvian coast and in the Amazon, it is expected to be faced with potential legal actions from communities and environmental regulators. Local communities are organizing to demand reparation and compensations. There is an alliance between Amazonian and Coastal communities, which soon will represent strong opposition to oil operations all along the North Peruvian oil circuit. In the case that Petroperú assumes the operation of these blocks, there is a risk of future demands against Petroperú since it will assume all assets and liabilities.

The picture is clear: investments in Petroperú create enormous political, legal, reputational, climate, and social risks for financial firms.



Achuar protest vs. Petroperú in Block 64



Remnants of “remediation” mark a recent oil spill site near Cuninico, a Kukama Indigenous community on the Marañón River in the northern Peruvian Amazon. Within a span of six months in 2013, five separate spills have resulted from breaks in Petroperú’s North Peruvian pipeline. Credit: Caroline Bennett/Amazon Watch

Introduction

Petroperú is a Peruvian state-owned company that has plunged into a risky financial situation caused by its mismanagement and over-indebtedness due to the modernization of the Talara Refinery. Petroperú’s high-level executives are politically appointed and have seen the company as a spoil of resources available to them. In this context, Petroperú’s operations are poorly managed, particularly the North Peruvian Pipeline, which has a history of recurrent oil spills in the Peruvian Amazon that has affected the survival of many communities. For many years, Petroperú has operated in the midstream and downstream business segments and very recently has returned to the upstream business. Currently, the company is seeking to explore and drill oil to feed the costly Talara Refinery.

Many banks have aligned their ESG policies with a commitment to achieve net zero carbon emissions with their portfolios by 2050. And for several years Indigenous communities have called for a global pact to permanently protect 80% of the Amazon by 2025. Banks have a responsibility to adjust their policies to avoid financing oil companies, such as Petroperú, which not only faces corruption charges, but also negatively impacts Indigenous communities.

Any investor should know that investing in Petroperú presents more than just financial risks. The following Risk Assessment will describe the political, social, financial, environmental, and legal risks associated with investing in Petroperú. It also compiles the perspective of some communities who could be affected by the threat of oil operations by Petroperú, in particular, the Achuar People of the Pastaza River and the Autonomous Territorial Government of the Wampis Nation. Indigenous communities are the main protectors of the Amazon and the main actors in the fight against climate change, therefore ESG policies should include their voices and perspectives. As will be explained in this Risk Assessment communities living in close proximity to Petroperú’s operations – especially near Block 64 – have strongly opposed oil drilling for decades.

AMAZON TIPPING POINT

The conservation of the Amazon rainforest should be a priority for financial firms with existing climate and biodiversity commitments. It is a natural wonder that plays a crucial role in regulating the climate, making any threat to its stability an existential threat to the entire planet. The rainforest’s tree canopy generates its own rainfall, supplying fresh water to several South American countries, hosting more biodiversity than any other biome

on Earth, and absorbing an estimated 2 billion metric tons of carbon dioxide from the atmosphere each year (roughly 5% of annual global emissions).¹ Scientists estimate that 80% of the Amazon’s tree cover must remain standing in order for the rainforest to maintain these functions.² Once enough is deforested, however, it will reach a catastrophic tipping point, at which it will convert from being a lush jungle (and carbon sink) to a grassland savannah. Without sufficient trees to create rain, the savannah will have less frequent and more unpredictable rainfall, leaving the region drier and more vulnerable to fire. The fires destroy any surviving trees, releasing an abundance of carbon into the atmosphere and ensuring that the canopy cover required to produce the rainfall needed for the forest to regrow, cannot be established. This phenomenon—the conversion of the Amazon from rainforest to savannah—will undoubtedly wreak havoc on its inhabitants, global weather patterns, and food and water availability.

To keep the Amazon from reaching this tipping point, deforestation and biodiversity loss must be rapidly curbed. The rainforest is currently losing ground quickly to a number of industrial activities, including oil and gas drilling. Biodiversity is essential for maintaining healthy ecosystems, providing fresh water, pollination cycles, soil fertility, and food production, as well as protecting against the spread of zoonotic illness and species extinction. Biodiversity is also inextricably linked to climate, such that good functioning of both is required for our quality of life.

The oil and gas industry in particular is a major driver of deforestation in the western Amazon, where oil companies often are the first to cut down trees in order to carve roads into the rainforest. This not only clears land for their immediate operations but also encourages further deforestation by opening up new parts of the forest to exploitation from other kinds of industries.

Company Background

Petróleos del Perú - Petroperú S.A. (www.petroperu.com.pe) is a state-owned company that has been listed on the Lima Stock Exchange since 2010. Its organization is conducted under private law and is regulated by the General Law of Companies (Ley General de Sociedades in Spanish), Law 26887.

Sector Oil and Gas Exploration and Production

Key Officers

- ⊙ President of Board of Directors: Humberto Campodónico
- ⊙ Chief Executive Officer and Chief Financial Officer: Beatriz Cristina Fung Quiñones
- ⊙ Chief General Secretary: Gustavo Alonso Galván Pareja
- ⊙ Chief Audit Management: Percy Ronald Espino Menacho

Financials

- ⦿ S&P Quality Ranking: BB (downgraded in April 2022 to BB “Credit Watch with Negative Implications” until July 2022 when changed to BB Stable.³⁾
- ⦿ Fitch Rating: BBB- (downgraded in March 2022 due to “lack of financial transparency and weakened governance”⁴⁾



Rainforest has been cleared to make way for helicopter landings in order to transport company workers to the site of a recent oil spill in Peru's northern Amazon.

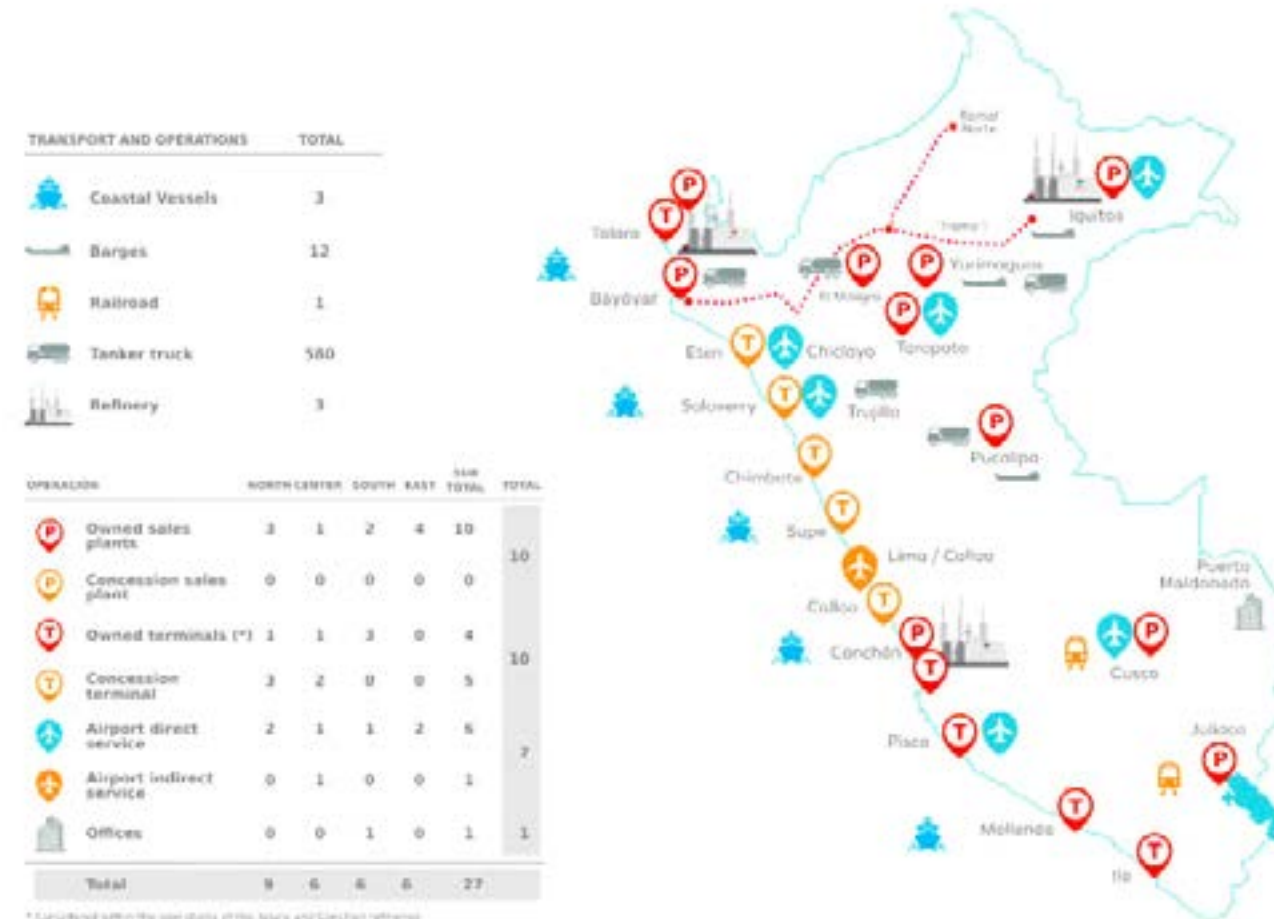
Snapshot of Petroperú's Operations

Until the end of 1997, Petroperú operated and drilled oil blocks in the north Peruvian Amazon and along the coast, including blocks 8, X, and Z-2B.⁵ In 1996, President Fujimori promoted a policy of privatizing state-owned companies and Petroperú was no exception. As part of the policy, all blocks operated by Petroperú were given to other oil companies, and Petroperú stopped operating in the upstream business. Due to that policy, Petroperú has been operating only in the midstream business, transporting crude oil through the North Peruvian Pipeline, barges, and vessels; and the downstream business, refining and commercializing oil derivatives. Since then, there have been many attempts for Petroperú to return to the upstream business, meaning the exploration and drilling of oil wells. Only recently, in 2021, did Petroperú finally return to the upstream business.

PETROPERÚ'S OPERATIONS IN THE MIDSTREAM AND DOWNSTREAM BUSINESS

Petroperú operations in the midstream and downstream business are distributed in different Peruvian regions.

MAP 1: PETROPERÚ'S NATIONAL OPERATIONS



Petroperú has 3 refineries; 10 point of sale storage tanks (which are oil storage tanks for sales); 10 oil sales terminals (which are oil storage tanks for sales close to the coastline), 5 of which are owned and 5 are under concession; and 7 airport sale storage tanks (which are oil storage tanks for sale close to the airports), of which 6 operate as direct service providers, and 1 as an indirect service provider. Petroperú does not own fuel service stations; however, it was able to establish a network of service stations affiliated with the Petroperú brand. Source: Petroperú (2022)

The headquarters of Petroperú is located in Lima, Peru, as are most of the administrative personnel managing national operations. This physical distance contributes to a disconnect between the workers and the day-to-day operations in the regional plants and terminals, making them prone to make decisions with no field or terrain knowledge. Each of these operating units has its own operational problems that could be further analyzed. However, this Risk Assessment will focus primarily on the costly Talara refinery, the deteriorated North Peruvian Pipeline, and oil blocks in the northern Peruvian Amazon.

The Talara Refinery Modernization Project

The Talara refinery was built in 1917 and existed before the creation of Petroperú when it belonged to the International Petroleum Company (IPC). Following the nationalization

of the company, the Talara refinery came under Petroperú's management. Of the three refineries that Petroperú currently operates, Talara has always been the most productive. For that reason, since 1984 there had been unsuccessful attempts to modernize the refinery.⁶ It was not until 2004, when the Pre-feasibility Study was presented,⁷ that the modernization process formally started.

The former President of Petroperú's Board, Carlos Paredes Lanatta, has always criticized the lack of technical and economic projections of the modernization project.⁸ As will be shown below, the modernization of Talara led to over-indebtedness and plunged Petroperú into serious financial trouble.

According to data from the Bloomberg Terminal, the banks that participated in the financing of Petroperú are JPMorgan Chase, HSBC, Bank of America, Goldman Sachs, Santander, Bank of New York Mellon, Citibank, Deutsche Bank, BBVA, BNP Paribas, Scotiabank, Mizuho Bank, MUFG Bank, Sumitomo Mitsui, and an undisclosed lender. These banks should be aware that by financing Petroperú, they are indirectly impacting Indigenous communities living on the blocks where Petroperú intends to operate. These banks should have a due diligence policy and be aware of all the risks involved in investing in Petroperú.

The North Peruvian Pipeline

The North Peruvian Pipeline (*Oleoducto Norperuano* in Spanish) was built in the 1970s for the purpose of transporting light crude oil from the north Peruvian Amazon to the Peruvian coast.

MAP 2: THE NORTH PERUVIAN PIPELINE



The North Peruvian Pipeline (*Oleoducto Norperuano* in Spanish) has two sections: the Main Pipeline and the North Branch Pipeline, both connecting at Pumping Station 5 (Infographic 2). The Main Pipeline is divided into two legs. The first part, called Tramo I, starts with Pumping Station 1 in San Jose de Saramuro, Loreto, very close to Block 8, and goes to Pumping Station 5. The second part, called Tramo II, goes from Pumping Station 5 to the Bayovar Terminal. The North Branch Pipeline (*Oleoducto Ramal Norte* in Spanish) was built in 1976 to connect the Andoas station, close to Block 192, with Pumping Station 5 along the Main Pipeline. The North Branch Pipeline is serviced by the Morona pumping station, which is close to Block 64. Source: Gestión (2019)

As will be further explained in the environmental and social section, the North Peruvian pipeline has caused enormous environmental liabilities in the

Peruvian Amazon, affecting the surrounding communities. The pipeline has cost Petroperú approximately \$185 million dollars in economic losses from 2014 to 2021 due to the low transportation of crude oil and remediation costs associated with the spills.⁹

PETROPERÚ'S ENTRY INTO THE UPSTREAM BUSINESS

In December 2021, Petroperú returned to oil production after 25 years outside the upstream business. As mentioned above, during the privatization process promoted by then-President Fujimori in the 1990s, exploratory and drilling activities went to private companies, while Petroperú concentrated on refining, transportation, and commercialization.

Petroperú seeks to operate blocks under temporary contract

Petroperú has three oil concessions under its interest: Block 192, Block 64, and Block I. Only Block I is operational, while operations in Block 192 and Block 64 are suspended. Petroperú has the license to operate these two blocks, while Perupetro is currently in charge of the administration of these oil blocks, the state agency in charge of promoting, negotiating, signing, and supervising both public and private contracts for the exploration and exploitation of oil and gas in Peru.

Block 64

Block 64 is located in the province of Datem del Marañón, in the Loreto region. It overlaps with the ancestral territories of the Wampis Nation and the Achuar People of Pastaza.

Block 64 was granted to Atlantic Richfield Peru Inc. under concession in 1995. Since then, many other oil companies have attempted to operate Block 64, and all of them have been unsuccessful. In December 2016, Petroperú entered Block 64 as a non-operating partner with the company GeoPark Peru through a joint venture agreement. Petroperú owned 25 percent of the project and GeoPark had 75 percent. The operations were fully managed by GeoPark Peru; however, as will be explained in the social section, GeoPark left in July 2020 due to strong community opposition to any exploratory activity in Block 64.

After the departure of GeoPark, Petroperú took control of 100 percent of the license to operate Block 64. However, operations have been suspended since June 2019 due to *force majeure* because of the delay in the Environmental Impact Study and the lack of Free, Prior, and Informed Consent.¹⁰ Currently, Peru carries out a consultation process without respecting the international standards of the Free, Prior, and Informed Consent.

Block 192

Block 192 (previously called 1AB) is located in the district of Andoas, province of Datem del Marañón, and the districts of Tigre and Trompeteros in the province of Loreto, both of them in the Loreto region. This block overlaps the ancestral territories of the Achuar, Kukama, and Kichwa Indigenous peoples.

This block was operated by Occidental Petroleum Corporation (Oxy) from 1971 to 2000, and then by Pluspetrol Norte from 2000 to 2015. In October 2015, Petroperú was authorized – by Law 30357 – to participate in the exploration activities in Block 192 with a strategic partner. Despite this possibility, in 2015 Petroperú (the state-run oil company) declined to bid to operate Block 192. In 2015 Perupetro (the Peruvian oil licensing agency) signed a Temporary Service Contract with Frontera Energy for the operation of Block 192, which was finalized

in 2017. The contract was valid until February 2021, when Frontera Energy left operations. During the course of the contract, operations were constantly suspended for periods of time due to *force majeure* as a result of community opposition and problems in the North Peruvian Pipeline.¹¹

After the departure of Frontera Energy, the administration of Block 192 reverted to Perupetro. In July 2022, the Peruvian president Castillo issued a decree giving Block 192 to Perupetro and approving the license contract between Perupetro and Petroperú.¹² It is very probable that Petroperú will operate Block 192 with a strategic partner. Bank of America and Merrill Lynch have been acting as advisors in the process to select a new operating partner.¹³ In June 2021, the Board of Directors agreed to select the company Altamesa Energy Canada Inc. as a strategic partner for Block 192.¹⁴ In the political and social risk section, there will be more explanation about previous confrontations regarding the future of Petroperú in Block 192.

Block I

Block I is located on the Peruvian coast, in the districts of La Brea-Negritos and Pariñas, province of Talara, very close to the modernized Talara refinery.¹⁵ There are 59 communities within the perimeter of Block I.¹⁶

This block marked a milestone of Petroperú's return to the upstream business. In July 2021, President Castillo announced the government's interest in Petroperú's participation in all of the stages of oil production, including oil exploration and drilling. In December 2021, the operation contract of Graña y Montero Petrolera S.A. (GMP) ended, leaving Block I available. The same month, the government approved the signing of the licensing contract authorizing Petroperú to operate and drill in Block I.¹⁷

Blocks of interest to Petroperú

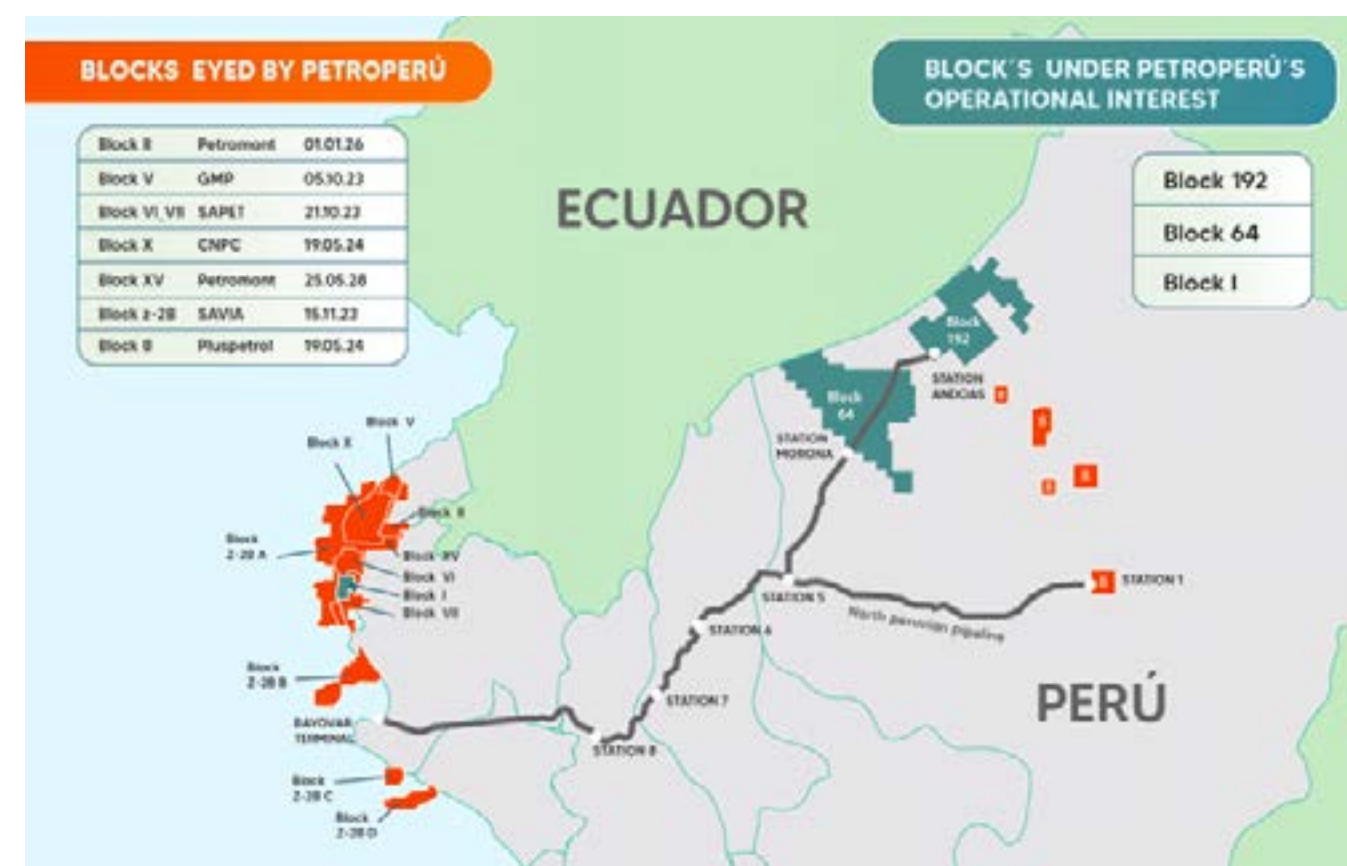
Similar to the situation in Block I, Petroperú is currently seeking to operate oil concessions soon to expire. Currently, there are approximately 10 oil concessions on the Peruvian coast and the Amazon that will expire between 2023 and 2028. The Peruvian government is advocating in favor of Petroperú taking over those blocks.

The blocks in the North Peruvian coast that are about to expire are Block V, Block VI_VII, Block II, Block XV, Block Z-2B, and Block X, and are located in the regions of Piura, Lambayeque, and Tumbes.¹⁸ Specifically, the contract of Block V is under the administration of Unna Energía S.A. (formerly GMP S.A.) and will expire in 2023. Block VI_VII is under the administration of SAPET Development Peru and will expire in 2023. Block II and Block XV are under the administration of Petrolera Monterrico S.A. (Petromont) and will expire in 2026. Block Z-2B is under the administration of SAVIA and will also expire in 2023. Finally, Block X is under the administration of China National Petroleum Corporation (CNPC) and will expire in 2024.

The only block in the Peruvian Amazon that will expire soon is Block 8 which is located in the districts of Trompeteros, Urarinas, and Parinari, in the Loreto region. It overlaps with the Achuar, Kichwa, and Kukama territories. Petroperú was the first operator of the block in 1970. However, as part of the privatization process, Block 8 was transferred to Pluspetrol Norte in 1996. The contract for operation will expire in 2024.

The Commission for Energy and Mines in the Peruvian Congress proposed to assign those blocks to Petroperú.¹⁹ However, political opponents of President Castillo modified the proposed law that would have authorized Petroperú's participation in these blocks, in order to extend the contracts of those blocks to their current operators, making it difficult for Petroperú to take over those blocks.²⁰ Currently, there are still political confrontations between the executive and the legislative branch over who will be the next operator of these blocks.

MAP 3: BLOCKS TEMPORARILY OPERATED BY PETROPERÚ OR OF INTEREST TO PETROPERÚ ALONG THE COAST AND AMAZON



Petroperú is interested in operating three oil blocks long-term, that it is currently operating under temporary contracts. From those blocks only one (Block I) is operational while the other two (Blocks 64 and 192) are suspended. On the other hand, members from the Peruvian government are advocating for Petroperú taking over some oil blocks located in the Peruvian coast (Blocks, II, V, VI_VII, X, XV, Z-2B) and Amazon (Block 8), which its contracts are soon to expire. Source: Amazon Watch based on public information (2022)

Political Risk: Government in Power

Petroperú's high-level executives are politically appointed. The highest executive leadership in Petroperú is formed by the Ministers and Vice-minister of the Ministry of Energy and Mines and the Ministry of Economy and Finances. They are in charge of selecting the Board of Directors, which directly designates the Chief Executive Officer. This situation represents a risk for investors because Petroperú's good corporate governance and administration depend on the government in power. As will be shown in this section, Petroperú has a history of corruption scandals and crises due to the mismanagement of these high-level executives.



An oil spill on Timu Entsa creek in Oil Block 1-AB

PETROPERÚ'S HISTORY OF CORRUPTION

The former president of Petroperú's Board of Directors, Carlos Paredes Lanatta, said in a 2019 interview, "To say that there is no corruption in Petroperú would be lying;"²¹ and the former president of the Peruvian Hydrocarbons Society, Beatriz Merino, stated in 2015 that, "[w]e all grew up hearing that the state oil company was the petty cash for the current government."²² Indeed, since the high-level executives are political appointees, they follow the orders of the government in power and use Petroperú's assets and resources for their personal benefit. One example is the use of Petroperú's resources by former President Alejandro Toledo to remodel the government palace and arrange housing for his security guards.²³

The most notorious scandal occurred in October 2008, during the term of former President Alan García, when audio recordings were broadcast between Rómulo León Alegría, former Minister of Fishing and member of García's political party, and Alberto Quimper, member of Petroperú's Board of Directors. They were discussing oil concessions in favor of the Norwegian company Discovery Petroleum in exchange for bribes. In the following days, Petroperú's Chief Executive and the Minister of Energy and Mines resigned. The scandal caused the resignation of the Garcia's entire cabinet.

Every Peruvian president – whether left-wing or right-wing – has used Petroperú at their will. The government of President Castillo has been no exception. In November 2021, it was made public that President Castillo met several times with the businessman Samir Abudayeh from Heaven Petroleum Operators (HPO). Days later, Heaven Petroleum won a contract to supply 280,000 barrels of B100 biodiesel to Petroperú. According to press coverage, the then-Chief Executive Officer of Petroperú, Hugo Chávez Arévalo, also participated in favoring the contract to HPO.²⁴

2022 has been characterized by constant crises for President Castillo and Petroperú. In February, the entire cabinet of ministers was replaced because of the ongoing political confrontations and instability. The Minister of Energy and Mines, Alessandra Herrera Jara, held that role for just one week and was then replaced by Carlos Palacios Pérez. At the same time, Petroperú was going through its own crisis. In March 2022, the Chief Executive Officer Hugo Chávez Arévalo resigned and was replaced by then-Chief Financial Officer Jesús Fernando de la Torre. As further explained in the governance section of this Risk Assessment, this replacement catalyzed Petroperú's financial troubles, since the consulting firm PricewaterhouseCoopers (PwC) refused to audit Petroperú's financial reports, which led to the downgrading of Petroperú's credit ratings.

As a consequence of the financial and institutional crises inside Petroperú, the highest executive leadership in Petroperú appointed Humberto Campodónico as president of Petroperú's Board of Directors. He previously held this position from August 2011 to January 2013. Campodónico is well-known as a promoter of the modernization of the Talara Refinery. Despite his past experience as president of Petroperú's Board of Directors, in May 2022, Humberto Campodónico had public confrontations with then-Minister of Energy and Mines Carlos Palacios. On many occasions as minister, Palacios threatened to fire Campodónico. One of the reasons was the administration of Block 192. Humberto Campodónico suggested operating Block 192 with a private partner, potentially Canadian oil company Altamesa. However, Minister Carlos Palacios insisted that Petroperú should operate Block 192 alone without a strategic partner, even when Petroperú was going through its worst financial moments.

This dispute, on top of other issues like strong community opposition to mining in Las Bambas, led to the removal of Carlos Palacios. The newly appointed and current Minister of Energy and Mines is Alessandra Herrera Jara, who held the post previously for just one week. The new Minister is more aligned with Humberto Campodónico's perspective, and it is very likely that Petroperú will operate Block 192 with a partner.

CURRENT CORRUPTION SCANDAL UNDER PRESIDENT CASTILLO

According to the United States 2022 Investment Climate Statement on Perú, "recent political instability, corruption, and social conflict negatively impact Peru's investment climate. As of April 1, 2022, President Castillo had appointed four cabinets since taking office in July 2021. Allegations of corruption plague the current and previous administrations. Transparency International ranked Peru 105th out of 180 countries in its 2021 Corruption Perceptions Index. Peru's Ombudsman office reported 157 active social conflicts in the country as of February 2022."²⁵

Indeed, President Castillo is immersed in corruption scandals. The latest occurred at the beginning of August 2022, when the former secretary general of the presidency, Bruno Pacheco, who previously worked with President Castillo, declared before the Prosecutor's Office that he would have given President Castillo 30,000 soles (equivalent to USD 8,000) in exchange to appoint Hugo Chávez Arévalo as Chief Executive Officer of Petroperú.²⁶

Currently, President Castillo is the subject of legal proceedings in multiple cases involving alleged corruption. One of these is the case of Petroperú's agreement to acquire biodiesel from Heaven Petroleum Operators S.A., owned by Samir Abudayeh. The Prosecutor's Office requested President Castillo appear on August 12, 2022 to answer questions regarding the irregularities of this acquisition.²⁷ However this date was re-scheduled to August 25, 2022.²⁸

It is a reality that the government of President Castillo is very unstable, in constant crisis, and seen by its political opponents as weak. The constant changes and disputes of Petroperú's high-level executives put the company in a very unstable position, which increases the risk for bondholders and bank lenders.



A child plays around the common yard in the Kukama Indigenous community of San Pedro in the northern Peruvian Amazon. The region is marked by oil operations, primarily operated by state-run company Petroperú. Credit: Caroline Bennett/Amazon Watch

Social Risk: Community Impacts

For decades, Amazonian Indigenous communities in Peru have opposed extractive industries within their territories. In the 1970s, when the Peruvian government granted contracts to operate oil concessions, environmental legislation in Peru was not yet developed, and the international normative framework around Indigenous rights had not yet been fully established as it is today. During this time, oil companies carried out extractive activities in the Peruvian Amazon without the agreement of surrounding communities, causing negative impacts to local residents.

This section will show that despite Petroperú's interest in exploring and drilling oil in the North Amazonian region, communities impacted by Block 64 have always strongly opposed those operations. Similarly, communities surrounding Block 192 faced environmental impacts from past operations

and are demanding environmental remediation. For those reasons, both operations in Block 64 and Block 192 are currently suspended.

Moreover, the future blocks that Petroperú seeks to operate in the Amazon and the coast have a history of negative environmental impacts and community opposition. Investing in exploration or drilling in any of them is a risky investment.

NORTHWEST AMAZONIAN COMMUNITIES

The Indigenous communities who live in Block 64 have been successful in expelling every oil company attempting to operate Block 64 since its creation in 1995. Neighboring communities have suffered negative impacts from operations within Block 192, which started to operate without Free, Prior, and Informed Consent.

Longstanding community opposition to any operation within Block 64

Since the creation of Block 64 in 1995, the communities living there have strongly opposed any oil exploration and drilling within their territories. They have been successful in expelling a growing list of international oil companies from Block 64 over the course of more than 25 years. The communities living within Block 64 are the Achuar People of the Pastaza River and the Autonomous Territorial Government of the Wampis Nation. Here, there is a brief description of these communities:

- ◉ **The Achuar People of the Pastaza River:** The ancestral territory of the Achuar People are found within the southeastern part of Ecuador and the northwest of Peru. There are approximately 12,500 Achuar in Peru, living in approximately 77 communities along the Morona, Pastaza, and Corrientes rivers. These communities have for centuries lived from traditional activities such as hunting, fishing, and farming.²⁹ A subgroup known as the Achuar People of the Pastaza River live in 46 communities of the Pastaza and Morona river basins. They are organized into several federations that come under the umbrella of the Peruvian Federation of Achuar Nationalities (FENAP).
- ◉ **The Autonomous Territorial Government of the Wampis Nation:** The Wampis Nation has also lived in the Amazon for thousands of years, prior to the existence of the Peruvian State. Their territory covers an extensive Amazonian area, between the south of Ecuador and northern Peru. They are located mostly in the Amazonas region, specifically in the district of Santiago River, Condorcanqui province. In pre-colonial times, the Wampis territories would have reached the Pacific Ocean.³⁰ The Wampis are characterized by the defense of their territory and the use of strategies, policies, and diplomacy closely related to their ancestral worldview. In order to achieve this goal, in November 2005, the Wampis formed their own political organizational structure. It has an executive government whose highest authority is called the Pamuk, as well as an Assembly formed by 105 representatives who hold legislative power.³¹

Both groups are currently seeking legal recognition of their integral territories and to exercise autonomous governance with their own world visions and structure. The Autonomous Territorial Government of the Wampis Nation (GTANW) is currently *de facto* acting as an autonomous nation. For its part, The Peruvian Federation of Achuar Nationalities (FENAP), gathering 46 communities, is seeking legal status. FENAP is composed of four base organizations, the Organization Achuar Chayat (ORACH), the Achuarti Iruntramu (ATI), the Indigenous Association of Morona (AIM), and the Achuar Federation of Yankuntich (FEASY).



MAP 4: BLOCK 64 AND OVERLAPPING COMMUNITIES

This map was elaborated by Perupetro in order to identify the individual Achuar communities overlapping with Block 64. Currently, the Achuar People of the Pastaza River is looking for a titling of their integral territory and not as it is currently shown as individual communities. Source: Perupetro (2022)

Peru ratified the International Labor Organization's Indigenous and Tribal Peoples Convention (Convention 169) in December 1993, and the Convention took effect in Peru in February 1995. A few months later, Block 64

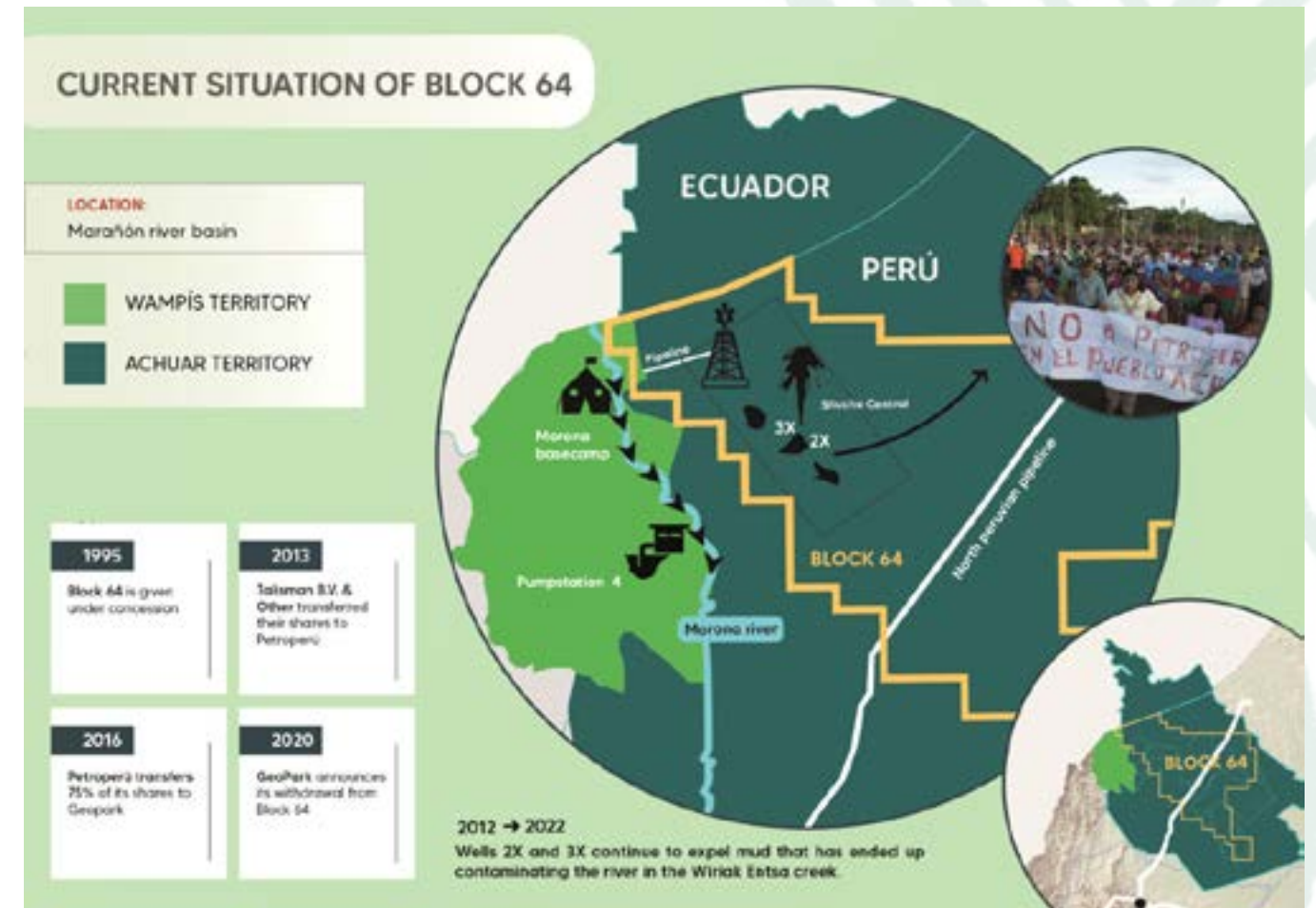
was created. Despite the fact that ILO Convention 169 was enforceable in Peru at the time, Perupetro (the Peruvian oil licensing agency) granted the concession of Block 64 to the oil company Atlantic Richfield Peru Inc. (ARCO) without the Free, Prior, and Informed Consent of impacted Indigenous peoples. From the beginning of Block 64, Indigenous communities expressed their opposition to extraction, signaling that they were not consulted as required by law. Furthermore, no one informed them of the contract; they learned the news about the oil concession from the press.³² Over the coming years, a parade of international oil companies attempted to operate within the block but was successively rejected and expelled by determined community opposition.

In 2003, ARCO sold its contract license to three companies: Occidental Exploradora del Peru Ltd. Peru Branch, Repsol Exploración del Peru, and Burlington Resources Peru Ltd. Peru Branch. The consortium managed to secure the approval of an environmental impact study to start drilling in the area known as *Situche*. To ensure the success of the operation, and with knowledge of the strong community resistance from previous years, the companies decided to carry out maneuvers to divide and conquer the communities. This would not be the first time that oil companies have used this kind of tactic.³³

One cynical tactic that oil companies promoted to manufacture the appearance of community consent was to create shell organizations by co-opting leaders from the areas close to *Situche*. The new organization was called the Achuar Federation of Morona (FASAM) and comprised eight communities and villages. This situation generated tensions and confrontations between the Achuar, some of which were close to resulting in episodes of violence.³⁴

Despite the corporate efforts to divide residents, by the end of 2003, the oil company Burlington Resources Peru Limited (Peru Branch) withdrew from Block 64. One of the main reasons was strong community opposition.³⁵ Shortly after, in March 2004, Block 64 was transferred to Occidental Exploradora del Peru and Occidental Petrolera del Peru. Subsequently, Canadian company Talisman Energy and U.S. company Amerada Hess, which in 2008 united under the name of Talisman Petrolera del Peru LLC, Peruvian Branch and acquired 100 percent of the operations.³⁶

FIGURE 1: CURRENT SITUATION IN BLOCK 64



Timeline and current status of Block 64

From **2008 to 2013**, the oil company **Talisman** used the same division tactics as previous companies, promoting the creation of new shell organizations. The organizations created were the Shakai Achuar Organization of Morona (OSHAM), composed of four communities; and the Achuar Indigenous Federation of Morona Katira (FIAMK), composed of four other communities. These organizations claimed to be representatives of the Achuar communities but have little legitimacy within the broader Achuar people.

As a response to the company's tactics, the Achuar community leaders from FENAP traveled to Calgary, Canada on multiple occasions, speaking out during Talisman's annual shareholder meetings.³⁷ They brought evidence of community opposition directly to its CEO, board of directors, and shareholders. Eventually, Talisman announced in September of 2012 that it would leave Block 64, finalizing its departure in 2013. That year, Achuar communities protested the block's transfer back to PetroPeru, which garnered international press attention in *The Guardian*.³⁸

From **2014 to 2020**, the Chile-based oil company **GeoPark** sought to operate Block 64. In late 2016, 75 percent of the block's interests were awarded to GeoPark Peru. GeoPark repeated Talisman's dirty tactics, with its revival of organizations FASAM and FIAMK to attempt to demonstrate ostensible community support for the project.³⁹ The Achuar's campaign

of resistance was also re-ignited in 2016⁴⁰ and intensified in the following years. In 2018, the Wampis Nation joined the effort, allying themselves with the Achuar in opposition to GeoPark in general and Block 64 in particular. The campaign culminated in 2019 when a delegation of Achuar and Wampis leaders traveled to Santiago de Chile and confronted CEO James Park at the company's annual general meeting.⁴¹

In 2020, during the toughest and most dangerous period of the COVID-19 pandemic, while the entire country was going through one of the strictest quarantine regimes in the world, GeoPark's community relations personnel entered the Block 64 violating all safety regulations, and putting the lives of the Indigenous communities at risk.⁴² This action was denounced by the Wampis Nation as criminal. Two months later, in July of 2020, GeoPark announced its departure from the concession.

MAP 5: NATIONAL AND INTERNATIONAL DEMONSTRATIONS OF COMMUNITY OPPOSITION TO OIL ACTIVITIES



Steady community opposition to oil drilling within Block 64

After the departure of Geopark in 2020 Block 64 has been under the administration of Perupetro (the Peruvian oil licensing agency), and the license of operations under Petroperú (the state-run oil company). In February of 2022 – with the ongoing pandemic – Perupetro organized a “community gathering” to introduce the new operator Petroperú to the communities potentially affected by operations of Block 64.⁴³ The Achuar and the Wampis again denounced Perupetro for putting their lives at risk since the pandemic is ongoing.⁴⁴

Having dealt for more than a decade with a parade of oil companies attempting to operate Block 64, both base organizations FENAP and GTANW decided to join forces and organized an assembly in the native community of Yankuntich, in the Morona River basin. Yankuntich was chosen because this community previously formed part of FASAM, one of the shell organizations created with the support of oil companies. However, in 2019, Yankuntich separated from FASAM and then affiliated with FENAP, demonstrating their total rejection of oil activities within their territory.

During their February 2022 assembly, both communities held an organized demonstration to show their opposition.⁴⁵ The community delegates unanimously expressed their distrust in Petroperú as an operator, given Petroperú's legacy of oil spills along the North Peruvian Pipeline. The assembly ratified its decision not to allow the entrance of any oil company to their ancestral territory and stated that Petroperú had environmental liabilities that had not been remedied in the neighboring communities, such as Chuintar.

Both communities manifested that they will apply their own justice in the case of oil companies attempting to operate. They also denounced the Peruvian government for failing to learn from its bad practices of the past - such as the creation of shell organizations - and exposing both communities to health risks by holding a “community gathering.” Indeed, Perupetro requested the participation of the representatives in a “face-to-face information meeting” in the city of San Lorenzo,⁴⁶ just when COVID-19 infections were rising in the area, despite the fact that these communities had the lowest vaccination rate in the country. As a consequence of both communities' organizing, Perupetro canceled the event and was forced to announce that it would replace the face-to-face meetings with mail correspondence, facilitated by the installation of physical mailboxes in the municipalities, and email.⁴⁷

Recently, Petroperú with the help of the national government, has revived the use of long-standing dirty tactics used to divide the communities. In May 2022, influenced by the need to start oil production in Block 64 as a source of crude oil for the costly Talara Refinery, President Castillo met with the Achuar pseudo-leaders from the federations FASAM and FIAMK, to attempt to demonstrate community support for oil operations, when the historic reality is overwhelmingly strong community opposition.

Communities historically affected by oil operations in Block 192 demand environmental remediation

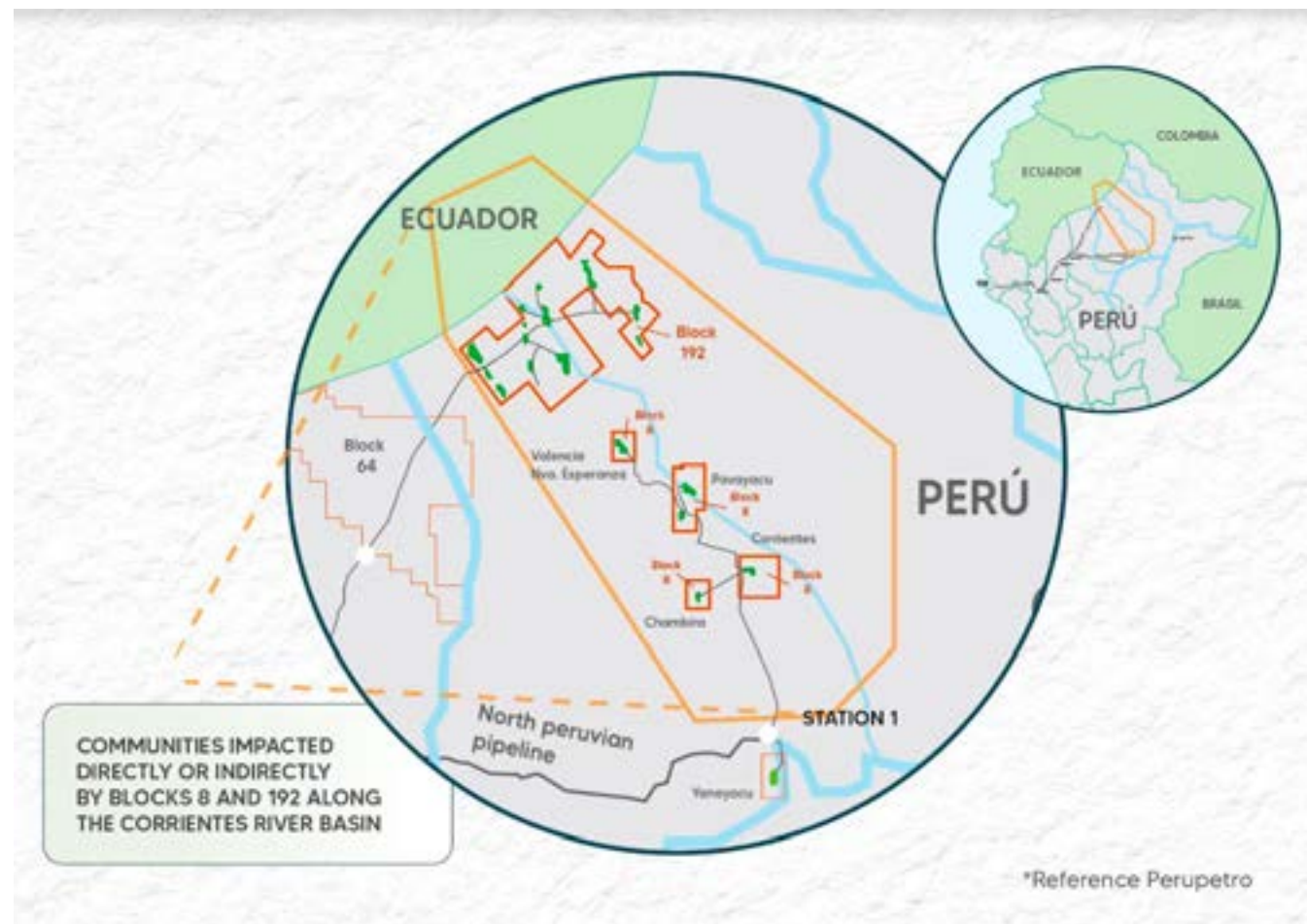
Block 192 is adjacent to Block 64 and Block 8 and is one of the most controversial blocks in Peru. Since its creation in 1970, it has been one of the biggest oil reserves in Peru. It overlaps with the territories of the Achuar, Kichwa, and Kukama peoples of the Pastaza, Corrientes, and Tigre river basins.

The Cuatro Cuencas community (Puinamudt Platform)

The Puinamudt platform overlaps 90 Indigenous communities from the Loreto region represented by four Indigenous federations. These communities are directly or indirectly affected by operations in Block 192 and Block 8, as well as the North Peruvian Pipeline.

Federations that are a part of Puinamudt are the Quechua Indigenous Federation of Pastaza (FEDIQUEP), the Federation of Native Communities of the Corrientes Basin (FECONACOR), the Cocama Association for the Development and Conservation of San Pablo de Tipishca (ACODECOSPAT), and the Organization of Amazonian Kichwa Indigenous Peoples of the Peru Ecuador Border (OPIKAFPE).⁴⁸

MAP 6: COMMUNITIES IMPACTED BY BLOCKS 192 AND BLOCK 8



Region of communities impacted directly or indirectly by blocks 8 and 192 along the Corrientes River Basin.

As mentioned before, in 1970 Peru had no regulations recognizing the Indigenous right to Free, Prior, and Informed Consent. Therefore, the adjudication of this block was made without any respect to the surrounding communities grouped today under the Puinamudt platform. The first oil company to operate Block 192 (formerly Block 1AB) was Occidental Petroleum Corporation (Oxy). Due to the increased and ensuing environmental regulations and obligations, Oxy sold its rights in 2000 to Pluspetrol Norte, which in turn operated the block until 2015.

Oxy left Block 192 with enormous environmental problems. When Pluspetrol Norte acquired the concession contract, it was unclear which company would assume the environmental liabilities. Pluspetrol operated under the assumption that it would assume the asset but not the liabilities. After years of operations, Pluspetrol Norte not only did not remediate those operations, but caused other negative environmental impacts. Pluspetrol Norte claimed that it was not responsible for those liabilities caused prior to its acquisition of Block 192. However, the Peruvian government responded that the remediation of those liabilities was part of the contract. Due to the controversy, there is an international arbitration process filed by Perupetro against Pluspetrol Norte in 2021 before the Paris International Chamber of Commerce.⁴⁹

The communities that would be impacted by oil operations in Block 192 denounced all the environmental damages to the operator Pluspetrol Norte. However, instead of addressing their concerns, the company sued the communities and the police threatened them.⁵⁰ According to the press report "Stained by Oil," Pluspetrol Norte received 73 sanctions for its operations in the Peruvian Amazon.⁵¹ After years of denouncing oil spills, asking for environmental remediations, and demanding to be consulted, some communities have accepted oil operations and their consequences. As mentioned previously, Peru carries out consultations with Indigenous peoples without respecting the international standard of Free, Prior, and Informed Consent. In 2015, a prior consultation process was carried out in which some communities accepted the entry of the Canadian company Frontera Energy as a temporary contractor for operations in Block 192, under the condition that remediation to environmental damages would be carried out. The Minister of Health formed a commission to perform an epidemiological study which exposed heavy metal contamination in the surrounding communities. Ultimately, Frontera did not remediate past environmental damages and communities manifested their opposition to continuing oil operations. During the execution of the contract operations were constantly suspended because of community opposition and operational problems. In 2021 Frontera Energy decided to leave Block 192.⁵²

That same year, the government carried out another prior consultation process with the impacted communities of Block 192. The communities again accepted operations within Block 192 under the same conditions of environmental remediation and economic reparation for past environmental damages. Petroperú currently has the license to operate Block 192, however, due to the political disagreements previously mentioned, Petroperú has not yet started operations. Since Frontera Energy left, operations in Block 192 have been suspended.

OTHER AMAZONIAN AND COASTAL FISHING COMMUNITIES AFFECTED: AMAZON-SEA UNITED

Other communities surrounding other oil concessions sought by Petroperú are manifesting opposition to oil operations. The blocks that Petroperú is looking to assume in the Amazon and along the Peruvian coast represent a risk because they also have a history of strong community opposition. In the event that these blocks come under Petroperú's administration, the company will face related legal, environmental, and social risks.

Communities affected by operations in Block 8

As mentioned before, the Puinamudt platform includes federations of communities that are directly or indirectly affected by operations in Block 192 and Block 8. This block was created

in 1970 and was under the administration of Petroperú. In 1996 as part of the privatization process led by then-President Fujimori, the Block was transferred to the company Pluspetrol Norte, whose contract will expire in 2024.

Currently, the license contract for Block 8 is in force until 2024. However, at the time of the drafting of this report, Pluspetrol Norte and Perupetro are in an international arbitration process slated to be completed in August 2022, due to Pluspetrol Norte's decision to dissolve and start its liquidation process. Therefore, Pluspetrol is only carrying out the maintenance and care of the facilities of Block 8.

Similar to that of Block 192, at the time of Block 8's creation, the environmental regulations were not developed. During the operations of Petroperú and Pluspetrol Norte more than 155 oil spills occurred in Block 8.⁵³ When Pluspetrol Norte announced its departure from Block 8, protests exploded. In January 2022, members of the San Juan Nativo community approached the industrial area of Block 8 carrying firearms and seizing a truck from the company. This situation is similar to what happened in August 2021, when communities stormed one of Pluspetrol's oil camps in Block 8 called "Percy Rozas."⁵⁴

Given that the concession contract for Block 8 expires in 2024, the Peruvian government has already initiated coordination to carry out a consultation process with the surrounding communities impacted by this block. But in order to get their approval, the Peruvian government must decide who will be responsible for the environmental liabilities in this area and also comply with various social and economic demands pending for decades. Similar to Block 192, Pluspetrol Norte will not accept responsibility for past environmental liabilities.

Communities affected by operations on the Peruvian coast

Between the coastal Peruvian regions of Piura and Tumbes, there are 1,200 operating oil wells that contributed 66 percent to the national oil production in 2018. This represents almost 12 million barrels of oil production, according to annual statistics from Perupetro.⁵⁵ This region is highly biodiverse in flora and fauna. In the surrounding communities, including Foca Island, El Nuro, Arrecifes, Cabo Blanco, Punta Sal, and Máncora, the main economic activity is linked to artisanal fishing.

This oil operation on the north coast is the oldest in Peru, and currently 90 percent of the environmental damages by oil operations in Peru are concentrated there. Since 1997, the Agency for Environmental Alert and Enforcement (OEFA) and the Supervisory Agency for Investment in Energy and Mining (OSINERGMIN) have identified 404 spills in coastal areas caused by oil exploitation and transportation.⁵⁶

Of the North Peruvian Coast oil blocks, Petroperú already holds the license to operate Block I, in which 10 spills have been registered that have not yet been remediated. The blocks Petroperú is interested in operating, explained in the section "Blocks of interest to Petroperú," whose contracts expire Between 2023 and 2026 have a similar situation as Block 192. Numerous unremediated oil spills have been recorded in these blocks. For example, there have been 65 spills in Block Z, and more than 159 spills unremediated in Block X. If Petroperú assumes these blocks, it is unclear who would be in charge of the remediation of previous environmental liabilities. Similarly, in the case of Block 8, located in the Peruvian Amazon,



Achuar protest against Petroperú.

previously operated by Pluspetrol Norte still has unsettled environmental liabilities. As with all the blocks Petroperú is interested in, it is not clear which company would assume the remediations.

The organizations of artisanal fishermen affected on the north coast of Peru, together with many other social organizations, have constantly requested the Peruvian government not grant more oil concessions or extend the terms of the oil block that are about to expire. In addition, these communities demand a planned and orderly transition towards a new energy matrix.⁵⁷ If Petroperú plans to operate these blocks, it will encounter opposition from the fishing communities, environmental liabilities, and potentially complex legal processes.

In recent months, the artisanal fishermen of Piura and Tumbes from the oil-impacted areas have created an alliance with the Amazonian leaders affected by the oil activities in Block 192 and Block 8. They have also expressed their solidarity with the Achuar and Wampis peoples' rejection of operations in Block 64. Therefore, a broad platform of allied social organizations is arising that will jointly demand modifications to the Peruvian oil and gas policy and will join forces to demand that Petroperú or any other operating company, which assumes all pending environmental remediations.

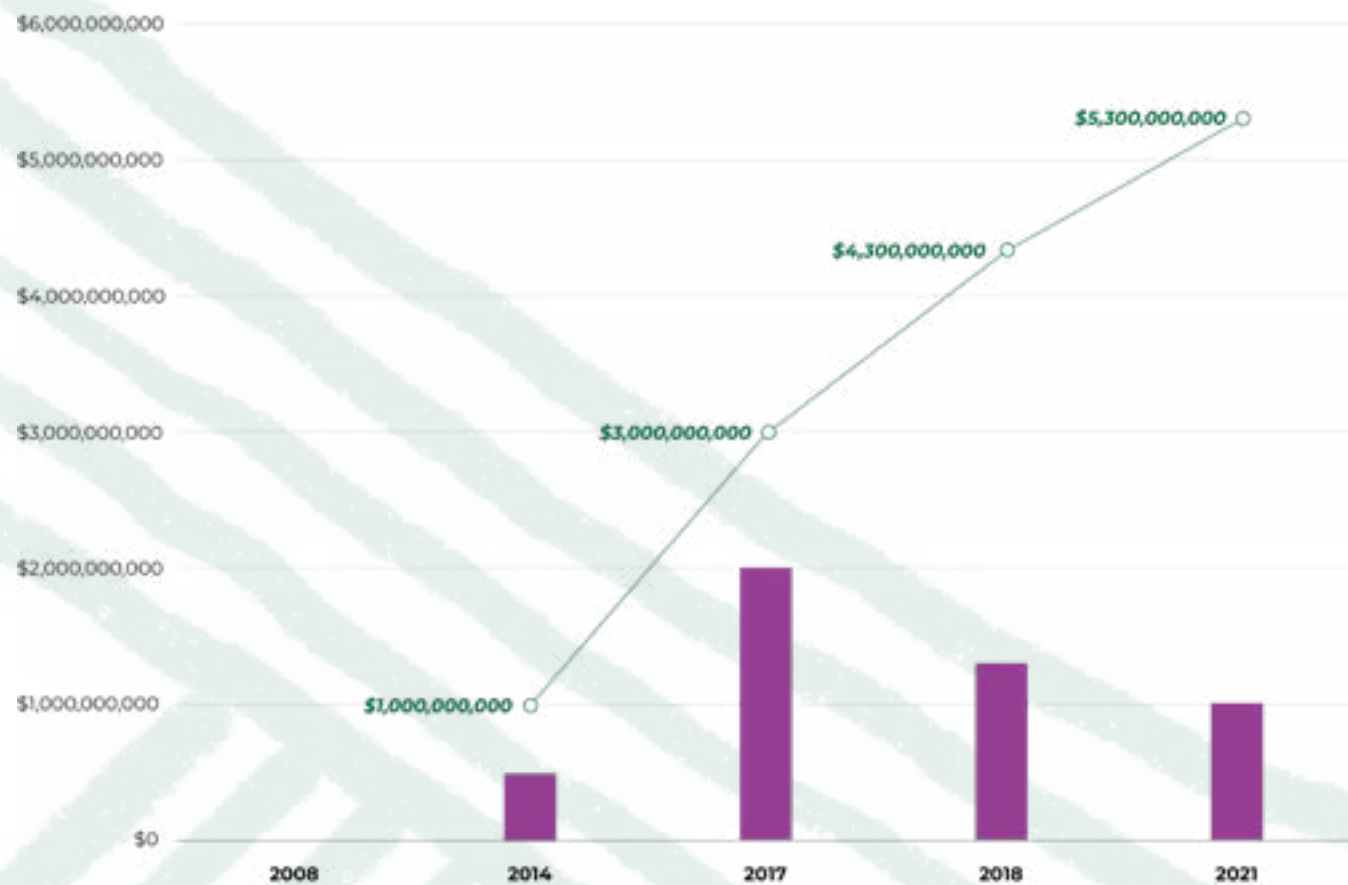
Governance & Financial Risk

Investing in a company with very little transparency is a risky business for investors. Petroperú started the year 2022 in the middle of a new crisis caused by internal disagreements among key management personnel.⁵⁸ Moreover, it is submerged in a financial hole caused by its over-indebtedness due to the modernization of the Talara Refinery coupled with very little crude oil production.

OVERSPENDING IN A GIANT REFINERY WITH LITTLE CRUDE OIL TO REFINE

The pre-feasibility studies for the modernization of the Talara Refinery started in 2004 and has had four cost projections over the period of 18 years. In July 2022, Petroperú released a statement signaling that according to Board Agreement No. 077-2022-PP, the estimated investment of the Talara Modernization Project was approximately \$5.3 billion.⁵⁹ To date, Petroperú still owes approximately \$4.3 billion. This amount can be separate into in \$2 billion for the issuance of the quasi-sovereign bonds in 2017, \$1.3 billion for a syndicated loan in 2018 in which Deutsche Bank acted as a facility agent, and \$1 billion for the issuance of bonds in 2021.⁶⁰

FIGURE 2: TOTAL COST AND DEBT PROJECTION FOR THE TALARA REFINERY



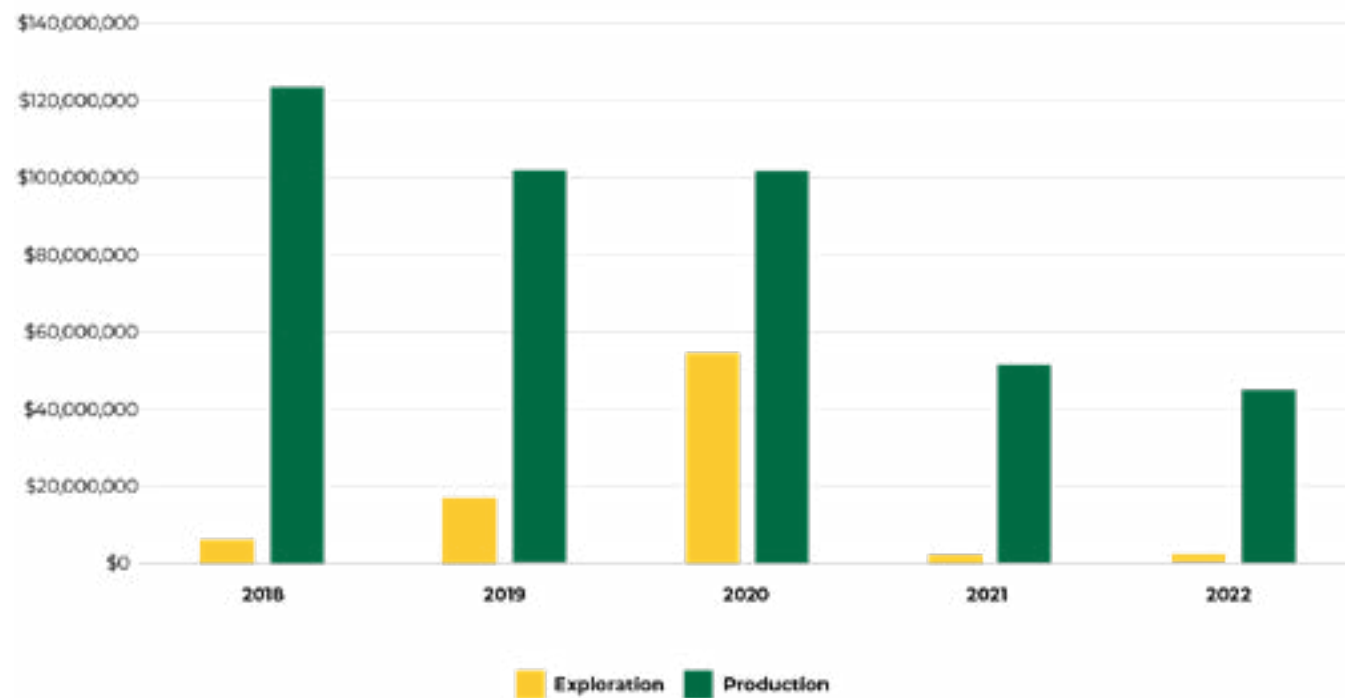
Total cost and debt projection for the Modernization Project of the Talara Refinery through time. The green line represents the estimated projected cost of the Talara refinery in each year. The purple bars represent the debt Petroperú was acquiring, either in loans and/or bonds, when each cost projection was made. Source: Amazon Watch based on publicly available data from Petroperú's Reports (2022).

As mentioned above, the former President of Petroperú's Board, Carlos Paredes Lanatta, has always criticized the lack of technical and economic projections for the modernization project.⁶¹ He has stated that this costly project was not a modernization *per se*, but instead the construction of a new refinery. If the project had the budget to build a new refinery, it would have been more cost effective to build it close to the sale points in the south of Peru, where Petroperú has most of its market. Paredes Lanatta argues that the transportation cost of the refined oil from Talara to the sale points in the south increases the selling price. He adds that these technical issues raise concerns for him about the viability of the modernization of the Talara refinery, especially since neither a technical nor economic study regarding its viability had been completed. Moreover, similar modernization projects, such as the one planned for the Esmeraldas refinery in Ecuador, will cost \$2.7 billion and not \$5.3 billion as Talara.⁶²

On April 12, 2022, with great fanfare, Petroperú started operations on the Talara Refinery and has not yet finished. According to an audit report from the Peruvian General Comptroller, "Until February 23, 2022, the real accumulated advance of the [Talara Refinery] was 97.21% but the reference scheduled advance was 99.60%, so there is a delay of 2.39%, which has not suffered any reversal since June 2021 when the delay was 2.33%."⁶³ Furthermore, the delay in the construction of the Auxiliary Units of the modernized Talara refinery caused an economic loss of approximately \$300 million.⁶⁴ The Comptroller also stated that at this stage, it is not possible to determine whether there was corruption during the modernization of the Talara Refinery. The audits will be carried out once the work is complete.⁶⁵ However, the cost overruns during the construction of the Talara Refinery can be an indicator of corruption that would need to be investigated in future audits carried out by the Peruvian General Comptroller. These future findings could once again put Petroperú in the middle of a new political and financial crisis that future investors would need to deal with.

In order to repay the enormous debt, Petroperú needs to maximize profits from the Talara Refinery and increase oil production, both of which are unlikely. Many communities in the Peruvian Amazon have strongly opposed any kind of oil drilling within their ancestral territory, meaning less crude oil is available for extraction. Due to such vehement opposition Petroperú closed the *El Milagro* refinery near Block 8 in 2015 and the Pucallpa refinery in 2018.⁶⁶ Despite these closures, Petroperú went ahead with the construction of the Talara Refinery.

According to a recent 2022 report by BNamericas, the "upstream [oil and gas] investment in Peru slid to a five-year low in the first quarter [...] The data shows that this year [2022] through April, there has been no seismic activity and no exploration wells were spud, while 15 development wells were drilled. In January - April 2021, there also was no seismic activity nor exploration wells and 30 development wells were spud."⁶⁷

FIGURE 3: PERU UPSTREAM OIL AND GAS INVESTMENT FROM JANUARY 2018 - MARCH 2022

This chart shows a reduction of investment in the upstream business in 2022, which shows that the oil and gas industry in Peru is in decline. Source: Chart elaborated by BNamericas based on Perupetro data (2022)

Yet, President Castillo's government continues to support Petroperú and the Talara Refinery despite the scarcity of crude due to strong community opposition. Petroperú's need for crude oil forced the company to seek the international market. One of the biggest oil suppliers for Peru is the neighboring country, Ecuador.⁶⁸ In April 2022, Petroperú bought almost 4 million barrels of Napo oil at \$0.72 per barrel. Ecuador also faces strong community opposition to oil drilling in its biodiverse Indigenous territories.⁶⁹ Crude delivery began in July 2022 and will continue until May 2023 to keep Talara running during that period.⁷⁰

In May 2022, Petroperú reached its lowest point. The company's financial situation was so precarious that Peru's Ministry of Economy and Finance needed to approved a loan of \$750 million to rescue Petroperú from financial catastrophe, help pay its short-term obligations for the fiscal year 2022, and to avoid a fuel shortage in Peru⁷¹

LOW FINANCIAL TRANSPARENCY

At the beginning of March 2022, the rating agencies S&P and Fitch downgraded Petroperú's debt. Petroperú's bonds became one of the worst-performing Latin American corporate bonds for the year 2022,⁷² and its benchmark notes edged down to 77 cents this month.⁷³

The downgrades came after international audit firm PwC refused to audit Petroperú's 2021 financial statements.⁷⁴ The controversy began after Petroperú removed key financial officers in charge of Petroperú's finances in 2021.⁷⁵ The newly appointed Chief Financial Officer, Jesús Fernando de la Torre, who would later become Petroperú's President of the Board of Directors, requested a confidentiality clause in the PwC audit contract, instead of the two

years previously agreed upon. This request raised concerns within PwC about transparency and corporate governance inside Petroperú, so PwC requested a meeting with Petroperú's high-level executives.

The critical moment that cemented PwC's refusal was when Petroperú requested that PwC deliver the report on May 31, 2022, instead of the previously agreed date of June 30, 2022. PwC argued that this earlier deadline would have given it less time to carry out the audit correctly. Petroperú's rush to have the financial statements audited by May 31 was due to its obligation to comply with this requirement to bondholders and lenders by the end of May 2022.

After various meetings between Petroperú and PwC, and with the intervention of the Peruvian Comptroller General, PwC and Petroperú agreed on May 10, 2022, to issue the report by September 2022. Petroperú's financial officers then traveled to Madrid and New York, seeking the approval of the syndicated banks and the bondholders to extend the deadline for the financial reports.⁷⁶ In Madrid, the Spanish Export Credit Agency (CESCE) that guarantees the syndicated loan, is participating as a coordinator; so is Deutsche Bank, as an administrative agent, alongside the other international banks. On May 30, 2022, these banks agreed to extend the deadline for submitting the financial statements.



An oil spill flows down Chuuntsa Creek in Oil Block 1-AB

Environmental Risk

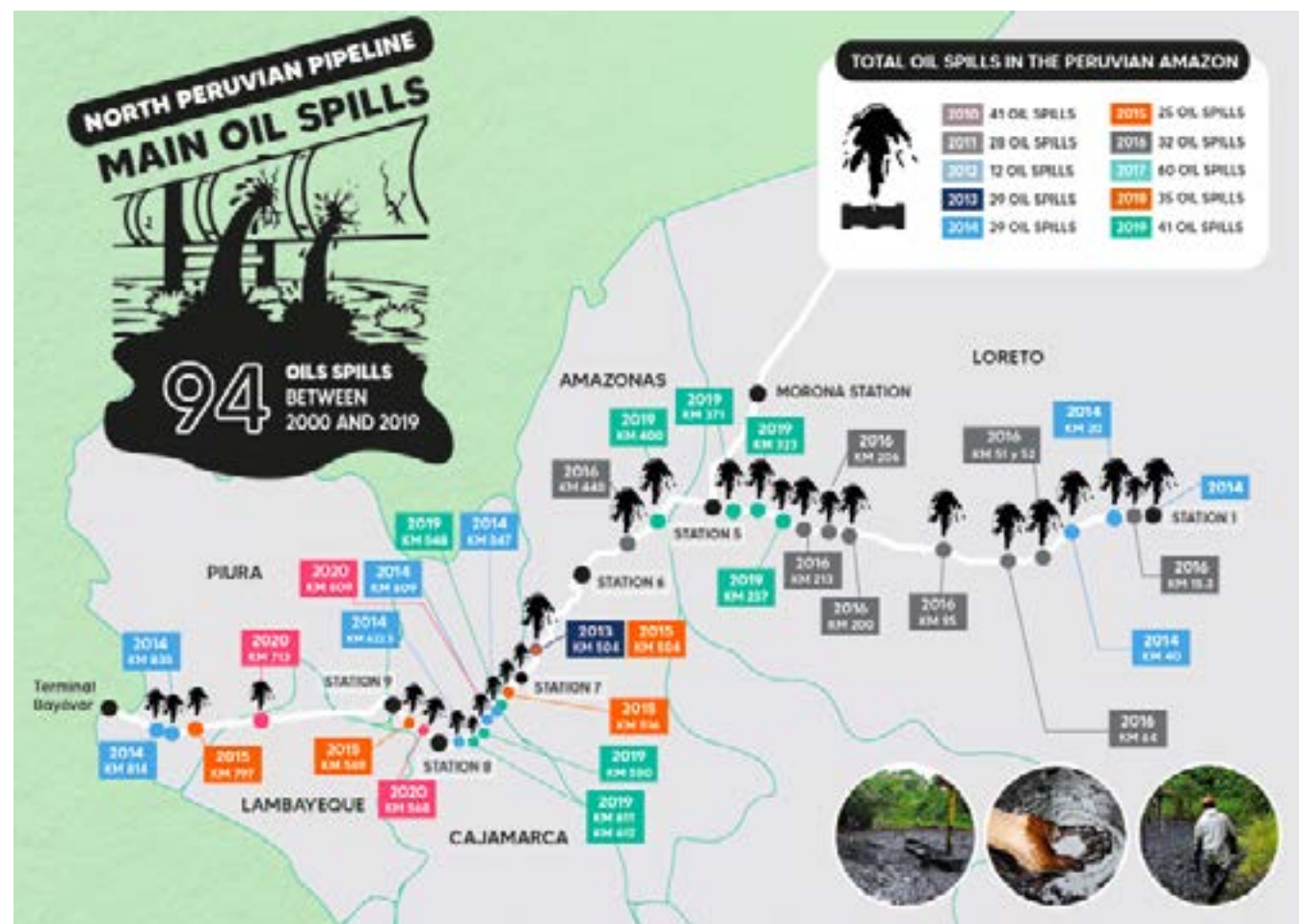
Fossil fuel extraction often causes immediate damage to the local environments in which it takes place, and the high rate of greenhouse gasses emitted in its consumption has longer-term damaging effects on the climate. Many financial firms already have environmental commitments to protect biodiversity, areas of high conservation value, protected areas, and internationally protected areas (including IUCN protected areas). The oil operations that

Petroperú carries out in the North Peruvian Amazon are of particular concern because it takes place in such a biodiverse, cultural, and ecologically rich region. The Peruvian Amazon also has the most oil reserves in the country, where most oil exploration and drilling are made in conditions that negatively impact the environment.

PETROPERÚ'S PERPETUAL OIL SPILLS IN THE PERUVIAN AMAZON

According to the Oxfam report *The Shadow of Oil*,⁷⁷ “[b]etween 2000 and 2019, 474 spills have been documented in Amazonian oil Blocks and along the North Peruvian Pipeline.” Petroperú is directly responsible for oil spills caused by the deteriorated North Peruvian Pipeline.

MAP 7: OIL SPILLS IN THE NORTH PERUVIAN PIPELINE



Recurring oil spills in the North Peruvian Pipeline (based on data from the 2016 Final Report of the Peruvian National Congress Investigative Committee tracking oil spills by the North Peruvian Pipeline and the report *The Shadow of Oil* by OXFAM)

The North Peruvian Pipeline

The decrepit North Peruvian Pipeline has caused 94 oil spills – from 2001 to 2019 – impacting communities all along the pipeline, from Station 1 to the Terminal Bayovar.⁷⁸ In response, Petroperú has claimed that most oil spills have been caused by acts of sabotage from third parties, however, the Oxfam report *The Shadow of Oil* shows that those oil spills were mostly caused by corrosion, operational failures, and unsafe conditions of the same pipeline. In

2016, OSINERGMIN, the Peruvian energy regulator, issued orders to suspend operations of the North Peruvian Pipeline due to an increase of oil spills in the Peruvian Amazon.⁷⁹ Petroperú disregarded the recommendation and continued operations, after which administrative legal actions were opened by the Peruvian regulator agencies OEFA and OSINERGMIN.

In November 2017, the Peruvian Congress carried out an investigation to look into the increasing oil spills. The report found that Petroperú included 28 cases of oil spills that were not actual oil spills but clandestine connections to the pipeline to steal oil. This intentional inclusion reinforced the narrative that most oil spills were caused by third parties. The report stated the potential danger of this characterization because it may be used as a tactic to cover up possible mistakes or compliance failures, which in this case are the result of piping corrosion and preventable natural phenomena.⁸⁰

The pipeline requires deep maintenance, and even a remodeling; however, Petroperú continues operations and just intervenes when there is already an oil spill. This approach is costly; according to the 2020 Petroperú Annual Report, Petroperú has invested approximately \$4.3 million dollars in remediation of environmental liabilities caused by the North Peruvian Pipeline.⁸¹

Block 192

When Block 192 was created, it was one of the biggest oil reserves in Peru. As mentioned above, Block 192 was operated by Oxy, Pluspetrol Norte, and Frontera Energy. Each has caused several oil spills⁸² with very poor environmental remediation. The main cause for oil spills within Block 192 was corrosion and operative failures due to very poor management of the operations.

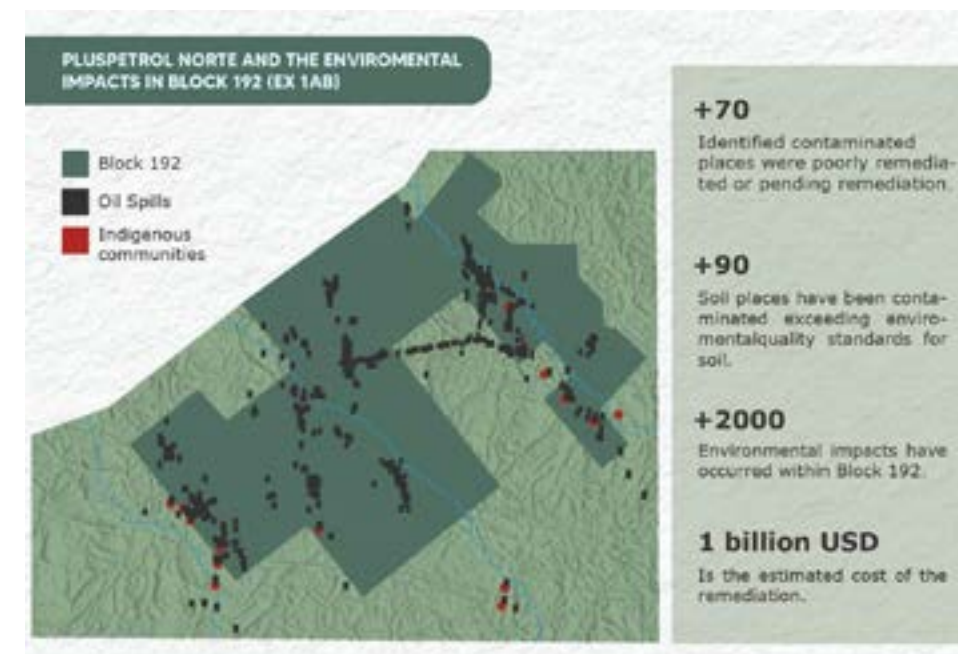


FIGURE 4: ENVIRONMENTAL IMPACTS IN BLOCK 192

Block 192 was operated by Pluspetrol Norte from 2000 to 2015. During this timeframe, more than 70 identified contaminated sites were poorly remediated or under pending remediation, more than 90 soil samples from contaminated sites confirmed exceeding environmental quality standards for soils, and there have been more than 2,000 environmental impacts by oil within Block 192. Source: Oil Observatory (Observatorio Petrolero in Spanish), Puinamudt (2016)

Despite the fact that Block 192 is currently suspended, the spills have not stopped. Most of these spills are caused by a lack of maintenance of the old and unused infrastructure, which causes pipe breakage and spills. At the beginning of the pandemic, there were more

than 8 oil spills in Block 192, affecting the following Indigenous communities: Titiyacu and Los Jardines in the Pastaza basin, Nueva Jerusalem, and José Olaya in the Corrientes basin, and the Doce de Octubre community in the Tigre basin.⁸³ In most cases, these communities warned the authorities and the company about the leaks, providing evidence such as geographical coordinates, and audiovisual records. However, they did not receive any response from Frontera Energy, the company in charge at the time.⁸⁴

In 1984, the Loreto region was declared one of Peru's most damaged critical environmental habitats. According to the Oxfam report *Negotiating Consent*, "In 2002, the enforcement arm of Peru's Ministry of Energy and Mines found 166 violations of Peru's environmental laws by Pluspetrol, including violations on how toxic wastewaters and byproducts of the oil production process, were being monitored, stored, and disposed of. In 2006, massive public mobilization by the Achuar peoples forced the suspension of oil production impelled by the finding by Peru's Health Ministry that heavy metals found in the communities exceeded World Health Organization limits. This activism forced the Peruvian government to require Pluspetrol to stop dumping 'production' or wastewaters into rivers or nearby soil."⁸⁵

Oil spills are more frequent in Block 192. The latest spill occurred on March 18, 2022, in the Tigre basin, in the oil well 10 of the Forestal field. Since the block is under the administration of Perupetro, the Specialized Prosecutor for Environmental Matters (FEMA) decided to open an investigation against Perupetro for alleged environmental pollution crimes.⁸⁶

Legal Risk

The operations of Petroperú in the Peruvian Amazon and the North Peruvian Pipeline have negatively impacted local communities and ecosystems, which led to economic sanctions against Petroperú, mostly given by the administrative regulator OEFA. Also, the possibility of operating new oil blocks with environmental liabilities can expose Petroperú to future legal cases and economic sanctions.

CURRENT SANCTIONS DUE TO OPERATIONS IN THE NORTH PERUVIAN PIPELINE AND AMAZONIAN BLOCKS

A recent press investigation carried out by Mongabay Latam, "*Stained by Oil*," states that Petroperú has the third-highest number of open legal cases for environmental damage in Peru. It currently faces eight cases that represent approximately \$5 million dollars in economic sanctions.⁸⁷

The highest economic sanction was given to Petroperú in 2018, after 2 years of investigations for the oil spills that occurred in January and February 2016 in Chiriaco, Amazonas, and Morona, Loreto. The environmental regulatory agency, OEFA, determined that Petroperú failed to comply with its commitment to provide comprehensive maintenance to the North Peruvian Pipeline. OEFA also added that the two spills caused severe damage to flora, fauna, and human health. Petroperú did not adopt any immediate actions in accordance with its contingency plan to prevent oil leaks to other places along the pipeline.⁸⁸



Oil sheens on the surface of the Marañón River in the northern Peruvian Amazon. Within six months of 2013, five separate spills have resulted from breaks in Petroperú's North Peruvian pipeline. The company has declared the site "remediated."

FUTURE LEGAL RISKS

As mentioned before, it wasn't until the 1990s that Peru strengthened its environmental regulations. As such, operators that entered contracts before that likely left big environmental liabilities for future operators. In assuming Block 8, Petroperú may assume the environmental damages left by its former operator Pluspetrol Norte – not only for its operations in Block 8 but also for Block 192.

On December 15, 2020, Pluspetrol Norte announced its dissolution, alleging an inability to pay the economic sanctions. OEFA, Peru's environmental enforcement agency, would have required Pluspetrol Norte to remedy the environmental liabilities left by Oxy in Block 192. Pluspetrol refused to pay the economic sanctions and preferred to quit operations in Peru. Nevertheless, according to new environmental legislation, oil companies must submit a closure plan before ending their operations, remedying all environmental damage caused. According to a recent journalistic investigation carried out by Mongabay Latam,⁸⁹ Pluspetrol Norte was the oil company with the highest number of legal claims for environmental damages in Peru. From 2011 to 2021, Pluspetrol Norte had amassed 73 claims, of which 72 resulted in economic sanctions of approximately \$47 million dollars.

Due to the imminent departure of Pluspetrol Norte from Peru, on April 5, 2021, OEFA requested a stay against Pluspetrol's remaining operations in Block 8, which is currently suspended. The affected communities prevented the oil company workers from entering the company's facilities when the workers tried to remove their equipment and machinery from the area of operations. Since then, oil drilling has remained paralyzed within Block 8. Moreover, the constant blockage of the Corrientes River due to community opposition affects access to Block 192. Certainly, the bad reputation and environmental damages left by past operators have caused skepticism and strong community opposition to continue any operation within Block 192. Currently, operations in Block 192 remain suspended.

As a consequence, it would be almost difficult, if not impossible, for Petroperú to continue operations in this block. If it does, it will have to contend with a huge legacy of spills, pollution, and community opposition.



The Achuar protest against Petroperú's plans to drill in Block 64 despite their repeated rejection of any oil activity in their territory.

Conclusion

Petroperú's governance is linked to the political situation in the country. Petroperú is not an independent private company and many of its executive decisions depend on external actors and forces. These include political and technical aspects, such as the designation of high-level executive managers, and decisions on whether Petroperú's operations will be carried out with strategic partners or not; social aspects such as community opposition to oil activities within their territory; financial aspects, such as debt management and political control over auditing; and socioeconomic aspects, which implies the company could be required to assume environmental liabilities of neighboring communities.

From the social point of view, Petroperú carries a negative image due to the past and current environmental damages caused by the North Peruvian Pipeline, and the enormous amount of corruption that Petroperú has been involved in. In addition, the entire oil industry in northern Peru will contend with organized communities that do not want oil drilling on their territories who also hold legal claims pending resolution. These claims are mostly regarding environmental remediation and economic compensation for all the environmental damage caused over decades. The affected communities will continue to organize themselves. Currently, the fisher communities of the north coast are following this same victorious example. The blocks where Petroperú intends to expand its operations will be subject to constant social pressure and will represent a risk for investors.

Financially, it is well-known that Petroperú is plunged into a financial crisis that has caused the downgrading of its financial ratings, and even to the point of needing a loan from the Peruvian government to cover day-to-day expenses. This situation, on top of the constant political crisis happening in Peru, makes Petroperú an unstable and unreliable company to invest in. The overrun in cost for the modernization of the Talara Refinery is one of the main reasons placing Petroperú in this precarious financial situation. Many of Petroperú's operations have not completed technical and economic studies. The modernization of the Talara refinery is a clear example of the lack of technical and economic knowledge inside the company.

As previously explained, in Block 192, Block 8, and the blocks on the north coast of Peru, the environmental damages generated during the concessions that have expired or are about to expire have not been accounted for or remediated, and Petroperú could be stuck covering those financial responsibilities. The legal conflict between the Peruvian government and Pluspetrol Norte regarding Block 192 foreshadows Petroperú's fate if it assumes other blocks. Those future problems imply uncertainty regarding potential partners, probable costly legal cases, and possible intervention of international arbitrators. If the last five years are an example, another aspect that can complicate operations are judicial or administrative actions in defense of the environment and community health that could paralyze the operation of the North Peruvian Pipeline.

The picture is clear: investments in Petroperú create enormous political, legal, reputational, climate, and social risks for financial firms.



A visit to an oil spill caused by a pipeline rupture in Oil Block 1-AB near the community of Antioquia.

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