CASE A: THE EXPROPRIATION OF REPSOL-YPF (ARGENTINIAN VERSION)

YPF: The Saga of a Resurrection

"YPF is now ours; it has been reclaimed for all Argentinians:
What more could I ask of life?"
"He always dreamed of recovering YPF for the nation."

Cristina Fernández de Kirchner

On April 17, 2012, Argentina's president, Cristina Fernández de Kirchner, announced—in final terms and epic style—the expropriation by law of 51% out of the total of 57.4% shares belonging to Repsol-YPF S.A.

The government of Argentina accused the Spanish group of a lack of investment in exploration and production, thus causing shortages in the domestic market and contributing to the fuel trade deficit. Likewise, the government defended the expropriation with the company's dividend distribution policy, which channeled shares mostly to foreign investors. Between 2008 and 2010, the company had earnings of US$12.92 billion and paid out US$14.91 billion in dividends.

The government's relationship with the Repsol-YPF Group until then had been very positive. Far from the alleged complaints about the lack of investment, in 2011, Cristina Fernández de Kirchner congratulated the oil company for increasing its oil and natural gas production. On December 7, 2010, YPF officially announced the discovery of a mega-site in Loma de la Lata, in the province of Neuquén. President Fernández chalked up the finding to evidence that including an Argentinian partner, the Petersen Group, in the company had been successful, encouraging foreign companies to incorporate national capital.

Argentina's economic environment at that time showed symptoms common to Latin American countries: an increasing deterioration in external accounts due to substantial increase in imports, capital outflows and average annual inflation rates of 25%. Approximately, more than 60% of Argentinian exportable supplies come from commodities and/or derivatives. Surprisingly, the energy sector has also shown external balance sheet deficits since 2009 (see **Exhibit 1a**). Consequently, the government has taken drastic economic measures to compensate for the external deficit and rein in the loss of dollar reserves, of which the most prominent is the expropriation of 51% of Repsol-YPF shares.

The dispute over fair compensation for the Repsol Group started on the day following the announcement of the plan to expropriate part of the company. The Argentinian government said it would not pay the compensation claimed by the Spanish company Repsol, as, in its opinion, the Spanish group had already earned more than enough in profit during the years it had owned YPF. The deputy economy minister said that, as required by Argentinian expropriation law, the share price would be set by the country's Tax Courts. He also underscored that, before paying, the environmental damage caused in various areas operated by YPF would have to be taken into account. The chairman of Repsol, Antonio Brufau, has demanded compensation of US$10.5 billion (plus expenses). Faced with the Argentinian government's refusal to negotiate the value of the company, Brufau confirmed that his company would sue Argentina at the ICSID World Bank tribunal for investment treaty cases.

The expropriation of companies was unprecedented in Argentina prior to the current government. In fact, in the nineties, under the presidency of Carlos Menem and his economy minister, Domingo Cavallo, the country saw a wave of privatization of 90% of state enterprises—like in most Latin American countries—to reduce and refinance public debt and also to help introduce technology into industrial sectors.

The government of former President Néstor Kirchner flipped this policy on its head.

YPF: Stock Ups and Downs

YPF is the leading energy company in Argentina, the largest producer of hydrocarbons and refined products, the largest investor, and one of the largest generators of employment (more than 46,000 people are employed directly or indirectly by the company). YPF's Board consisted of 17 directors, five of whom were independent, and included a government representative. The number of directors is considered appropriate for the company's sphere, and they provide the profile and experience diversity desired.

YPF's operations involve exploration, development and production of crude oil, natural gas and LPG. Downstream operations (marketing and processing) include the refining, sale, transportation and distribution of oil and a wide range of petroleum products, petrochemicals, liquefied petroleum gas and biofuels. It is also active in gas separation and natural gas distribution, both directly and through its investments in various subsidiaries.

In 1992, during the government of Carlos Menem, YPF was privatized through law 24,145: Yacimientos Petrolíferos Fiscales was an Argentinian state-owned company that became YPF

S.A. The government granted the company privileges to increase its value in the market and private sector, made up of banks and investment funds from various countries, which were increasing their share in the company.

In 1999, the Repsol Group acquired 85.01% of the company's shares for US$13.44 billion.[1] Although the Iberian bid met with initial resistance from shareholders, the Board recommended acceptance of the proposal. The oil and gas company based in Spain has operations in the energy sector worldwide. Repsol controlled 99% of YPF's capital from 2000 to 2008. In 2008, the Argentinian Petersen Group acquired 14.9% of Repsol-YPF, paying US$100 million with its own equity and taking funding from private banks and Repsol to acquire the entire stake, which was valued at US$2.24 billion. The remaining US$1.02 billion came from a pool of banks formed by Credit Suisse, Goldman Sachs, BNP Paribas and Banco Itaú Europa. In 2011, the Petersen Group increased its stake in YPF with the purchase of 10%more shares for a total of US$1.3 billion, taking ownership of 25.46% of the oil company. The payment scheme was similar: a consortium of several banks (Banco Itaú, Santander, Standard Bank, Crédit Suisse and Citi) contributed US$670 million and Repsol put forward a similar amount. Since September 2010, Repsol YPF has sold approximately 16.57% of the company on the stock market. As of September 30, 2011, Repsol-YPF controlled 57.43%, the Petersen Group owned 25.46% and the remaining shares were free-float, traded on the NYSE and Buenos Aires Stock Exchange (see **Exhibit 1**).

Company Results

[1] In late 1998, Repsol acquired 5.01% of the government's shares, and in early 1999, it purchased the remaining 14.99% for US$2.01 billion. In June 1999, Repsol bought 55% of YPF and 11% of the provinces reaching almost 90% of all company shares.

Since its acquisition in 1999, Repsol management has demonstrated successful financial and operational management (see **Exhibit 2a – 2b**). During the 1999 – 2011 period, sales increased annually by 24% on average, resulting in an average 16% net profit on sales per year. Profit on sales has continued to fall since 2004 (see **Exhibit 2c – 2d**).

This reduction is caused by the increased cost of sales due to more crude purchases from other producers and higher prices (about 22% in pesos) as a result of price adjustments between local producers and refiners, taking into account the exchange rate hike effect (since they are set in dollars). There were also increased imports of low-sulfur diesel fuel intended for manufacturing premium gas oil and standard car oil. This was done to meet the higher demand for these products in the local market and also comply with applicable regulatory requirements in this area. It should also be highlighted that in 2011, biofuel prices and sales volumes were increased (especially biodiesel and bioethanol) in order to include liquid fuels, in compliance with the provisions in force in Argentina.

Financial indicators have dropped since 2007 (see **Exhibit 6**). A decline can be noted in liquidity, solvency and profitability indicators. The current assets to total assets indicator has remained stable.

Investment, Production and Sales

Despite strong sales, the company's production of oil and gas barrels has dropped (see **Exhibit 3a**). Production of barrels has fallen on average by 4% per year from YPF's acquisition in 1999 until 2011. Likewise, over the same period, gas production fell by 3% annually, on average.

The oil industry has received a boost in recent years from the increase in international prices. Despite the global economic outlook, it has seen an upward trend in 2011, primarily due to the reduction of inventories in the United States, as well as geopolitical problems, especially in the major producing countries, affecting oil barrel price. Exports in oil and derivatives, in FOB prices, showed a downward trend after the economic crisis in Argentina in 2001. Exports measured in tons have shown an average annual increase of 6%. These results demonstrate the importance of the domestic market and international prices on increasing the company's sales. The average Brent crude barrel price was US$111.26 in 2011, US$79.61 in 2010 and US$61.74 in 2009.

The use of funds for investing and financing activities are geared towards the exploration and production business, refining and marketing, chemicals, and central administration. In 2011, approximately 67% was allocated to the business of exploration and production, 23% for refining and marketing, 8% to chemicals and 2% to central administration and others. In 2010, approximately 70% was allocated to the business of exploration and production, 20% for refining and marketing, 8% to chemicals and 2% to central administration and others. In 2009, 74% was allocated to the business of exploration and production, 20% for refining and marketing, 3% to chemicals and 3% to central administration and others.

Dividend Policy

Following the agreement signed in late 2007 between Repsol-YPF and the Petersen Group, promoted by former President Néstor Kirchner, the parties agreed to a dividend policy that proved satisfactory to both. It also contributed to giving the company's shares appeal in the markets in terms of an appropriate relationship between dividends and earnings (payout). To this end, they agreed to distribute 90% of the company's profits as dividends, in two installments each year. The stock purchase agreement stipulates that the Petersen Group pay for its share with what it receives as dividends. Thus, the dividend policy in some periods has exceeded the total net profit (see **Exhibit 2d**), just as the government of Argentina had warned.

Expropriation of the Company

The Argentinian government expropriated 51% out of Repsol-YPF S.A.'s total of 57.4% shares (Repsol retains a 6.4% holding), of which 49% will be distributed among the 10 provinces where the deposits are.

The rest of the shares held by the Petersen Group, plus those held by stock market investors, were not part of the expropriated shares. While the Petersen Group maintains its 25% share, it has no influence on company management. The Board of the new company will have a large majority of directors dependent on the national government.

The political opposition party and the general public demanded a 100% Argentinian-owned oil company. The company—whose management had been so applauded by President Fernández in 2010—was expropriated with international political costs and retaliation from the European Community as well as international organizations. Business and political sectors are concerned about the form of expropriation because they fear a deterioration of the image of a country which is legally safe for receiving direct investments, as well as a series of multi-million-dollar lawsuits that the next government will have to settle. An opposition lawmaker suggested that this set a precedent with severe consequences for the future, without a legal foundation and without a judicial process. There had been attempts to nationalize companies during the government of former President Néstor Kirchner. The results were quite unfavorable and very costly for the country; as has been the case of the canceled contract with Aguas Argentinas, which belongs to the French group Suez.

The Board of the new YPF is made up of 19 directors and 11 alternate directors. Axel Kicillof, deputy economy minister and advisor to the president, will be the director with most political weight in the company, and the golden share representative. YPF's CEO, Miguel Galuccio will be the only energy expert on the Board. Other Board members have survived the shuffle after vowing their allegiance to the new management: Carlos Alfonsi, refining and marketing director and Fernando Dasso, director of Human Resources. There is also a slot for Fernando Giliberti, responsible for designing the company's strategic plan. Independent directors include José Brizuela, Sebastián Utichel, Héctor Valle, from the Research for Development Foundation, close to Kirchnerism, and economist Eduardo Basualdo (Flacso).

The Board also includes Kirchnerism-leaning governors and officials representing the provinces: Roberto Ivovich, minister of economy of Santa Cruz; Oscar Crettini, a technical aide to the governor of Chubut; Martín Buzzi; Wálter Vásquez, a confidant of the governor of Mendoza; and Francisco Paco Pérez and Gustavo Nagel representing Neuquén. The four provinces will have permanent directors. Río Negro, in turn, will have a position that will rotate among the other producing provinces.

New Uncertainties in YPF

YPF's new financial controller formalized meetings with the country's leading financial institutions to convey a sense of stability. There was great concern in the financial system, especially because several large banks had risk exposure to the oil company, either as bondholders or due to directly funding the purchase of shares from the Petersen Group between 2008 and 2011. Until then, the maturity of these loans was covered with dividends earned by the Petersen Group as a YPF shareholder. In fact, since 2008, the oil company was distributing profits for more than 100% of its profits. The government's decision to halt the distribution of dividends and reinvest the oil company's profits meant that this payment scheme would dry up.

The agreement signed between Repsol and the Petersen Group in 2008 established that if Repsol ever lost the majority shareholding in the oil company, it would then be required to buy the Petersen Group's shares.

YPF controllers, the minister of planning and deputy minister of economy, have begun to hold meetings with representatives from international oil companies. They hope to attract private investors to finance the extraction and production of oil and gas. Along these lines, the company controllers have announced meetings with local oil company Medanito, associated with the U.S. energy company EOG Resources, specializing in the exploitation of unconventional resources such as those Repsol-YPF announced it had discovered last year in the Vaca Muerta formation. Meetings were also to be held with France's TOTAL executives, the chairman of Petrobras, Conoco Phillips (the third largest oil company in the United States), California's Chevron (formerly Standard Oil, owned by the Rockefeller family), Exxon and Talisman, a Canadian company based in Calgary, which until 1992 was part of BP.

Dividend Policy, Foreign Energy Deficit and Exploitation: The Crux of the Debate

The Argentinian government placed the first bet with the oil company for the dividend distribution policy. In 2011, it gave its shareholders a net payout of ARS$5.3 billion,[2] almost all of the year's profit, while the standard for the sector made provisions for 30%. The payout was US$4.44 billion in 2010 and US$4.9 billion in 2009. The profit distribution policy was abruptly interrupted in 2012 due to the government representative's refusal to approve the final balance sheet. His objection was that it did not adequately reflect or detail the company's economic and financial situation.

The government's arguments to expropriate Repsol's shares have not won over political opposition and industry experts, since the policy of dividends available to investors was an entry condition that was agreed between former President Néstor Kirchner, Repsol and the Petersen Group. The reason for expropriating only Repsol Group shares and not everyone else's shares was also questioned (see exhibit 7).

Industry specialists and former energy ministers argue that what has failed is the government's energy policy and its control mechanisms since privatization in 1992. Industry specialists assert that in recent years the country has suffered decapitalization to the tune of over US$100 billion, consuming the stock of proven reserves without replacing it. From 1998 to 2011, oil production declined by 32%, and from 2004 to 2011, gas dropped by 11%. Combined with an intense policy

[2] ARS$5.3 billion is equivalent to approximately US$1.25 billion per month at the May 2012 exchange rate.

of subsidies for domestic consumption, the industry ends up needing investments to expand the energy supply because it does not keep up with the growth of domestic demand.

In terms of its external fuel balance, in 2010, Argentina was again a net importer of hydrocarbons, after two decades of self-sufficiency. Its energy problems are egregious. To begin with, the loss of energy self-sufficiency is due to the fact that local installed capacity was insufficient to absorb domestic demand, where the growth of the car fleet was only 3.2 million vehicles in the last six years. This forced YPF to import fuels at an increasing rate, exceeding US$9 billion in 2011. Despite accusations of low investment levels, the company has reported recent investments: 2009 – US$1.36 billion; 2010 – US$2.16 billion; 2011 – US$3.26 billion. Although, admittedly, exploration and production have declined (see **Exhibit 2**), this applies across the board to other oil companies with subsidiaries in Argentina, which have not reported an increase in production and extraction (see **Exhibit 3b**).

Company Valuation: Crosshairs of the Conflict

After announcing the plan to expropriate YPF, the government said it would not pay the compensation requested by Repsol. For the government, the company is worth US$9 million. To anticipate any claims made by the Spanish company, the deputy economy minister said that, since joining YPF in 1998, Repsol had invested US$13 billion and had made US$22 billion.

The Repsol chairman announced intentions to sell its stake for at least €8.2 billion (slightly more than US$10 billion). This information appears in the Spanish company's annual report, which details the latest sales of YPF stock in 2010 and 2011. They include a small stock market listing, the purchase of an additional 10% from the Petersen Group and the sale of minor holdings to funds such as Eton and Lazard Asset. In 2010, Repsol sold 4.23% of it shares for €489 million, and the company's entire shareholding was then valued at US$11.56 billion. In 2011, it sold 22.38% of its share for a net amount of €2.33 billion and earned a gross profit of €478 million. That same year it sold its paper, which was worse off than in 2010, among other things, because it included the 10% bought by the Petersen Group based on a YPF assessment of US$12.13 billion. Company executives said that if annual earnings are discounted from the company appraisals made in 2010 and 2011, the approximate valuation of the company is US$11 billion. Below this line, Repsol would start generating losses, assuming that it would transfer all or part of its remaining 57.43% share.

The government's decision to go for control of YPF had its impact on the market value assigned to the oil company. The NYSE listing, followed closely by President Fernández, fell by 15.5% on the day of the announcement. The market valuation dropped from US$11.17 billion to US$9.44 billion. Experts say that YPF is worth more, but if it continues to be beaten back with revoked concessions, devaluation may continue. Whatever the speculation about the appropriate value of the company, the law stipulates that the company's price will be determined by the Argentine Court of Appraisals. If it fails to satisfy Repsol's claims, the possibility of going to court is very high, according to statements from its officials and the Spanish government itself.

Background of Recent Expropriations

In 2006, after long and fruitless negotiations between the government and the French group Suez, former President Néstor Kirchner decided to terminate the concession contract of Aguas Argentinas and create a state company. The government accused Aguas Argentinas of failing to comply with the agreed upon work plan for expansion and improvement of the service, and endangering the health of the population by the level of nitrates found in certain places. The company, however, rejected the government's allegations, and stressed that during its operation, two million people were given access to drinking water, and one million more to sewage services, highlighting that it invested US$1.7 billion. The International Centre for Settlement of Investment Disputes (ICSID), a World Bank agency, ruled in favor of Suez Environnement and GDF Suez. In exactly the same situation, it ruled in favor of Aguas de Barcelona (Agbar), which owned the water concession in the province of Santa Fe.

In 2008, the Argentinian government expropriated Aerolineas Argentinas, which was held by the Spanish group Marsans, with arguments similar to those wielded for the expropriation of Repsol shares. The management of the company is in the hands of government policy makers, whose early years of administration have proven to be a failure. In the first year, it needed a US$332 million government injection. The following year, in 2009, it required a total of US$612 million. In 2010, after a full calendar year of management, the assistance needed was US$575 million, of which US$38 million was earmarked for the purchase of new aircraft. In 2011, it received US$757 million, a record-high contribution. Government management of the company at that time resulted in daily losses of US$2 million, much worse than under the Spanish group.

Background of Expropriations in Latin America

"We are concerned by the Bolivian government's decision and announcement to nationalize the Spanish-owned electricity company. This comes on the heels, obviously, of the Argentine announcement," said U.S. State Department spokesman Mark Toner.

Given the emerging social and political pressures, new expropriations cannot be dismissed in countries with weak institutional frameworks, such as Venezuela, Argentina and Bolivia, according to the Moody's credit rating agency. It does deny, however, that the recent nationalization of Repsol-YPF and Transportadora de Electricidad (TDE) in Bolivia are a harbinger of a trend in Latin America. The nationalizations in Bolivia and Argentina have been perceived as confirmation of a growing differentiation between Latin American governments with strong credit profiles and favorable investment climates and those where these elements are not present.

The MERCOSUR Chambers of Commerce expressed concern over the expropriation of companies in the region and felt that this change in the rules affects FDI, urging governments to comply with the provisions for fair and proper compensation. For Brazil's National Trade Confederation, the business climate is being affected by some measures taken mainly by Argentina.

Expropriations have been one of the constant features in the Venezuelan government of Hugo Chávez. According to regional figures, Venezuela has seen 2,179 cases of asset seizures and encroachments since 2005. The state-owned Petróleos de Venezuela (PDVSA) paid US$250 million to the U.S. company Exxon Mobil as compensation for its assets nationalized in 2006. Exxon Mobil had sued Venezuela for US$12 billion, but the International Chamber of Commerce ruled that the country should only pay US$908 million. After discounts, according to the Venezuelan government, it only deducted that which had been canceled.

Future Challenges

Experts agree that rebuilding stocks requires opening over 100 exploratory wells per year. They are considered risky investments because the result of drilling for new deposits is uncertain.

The cost of developing a well in an active reservoir ranges between US$1 million and US$3 million. Exploration costs range between US$3 million and US$40 million, depending on the location and extent of the difficulties in the area. The provinces have so far designated 166 oil exploration areas. More than half of the areas (95) were awarded to companies with no experience in the business. No oil has been found in these areas and no investments have been made in most of them, according to a 2010 report by the former secretary of industry. The same study already warned about the general deterioration of the industry and especially YPF: between 2005 and 2010, exploration drilling sites dropped from 62 to 26 and YPF's from 16 to 5. Market agents agree that gas production faces more difficulties than oil. Of the five sites that are operational, four saw a drop in production. Prices are another weak link in the energy chain. International prices are more significant due to the current greater weight of imports. The domestic price of a barrel of oil is US$60, while overseas it is over US$100. The same applies to gas. Twenty percent of local consumption is imported, representing a cost of between US$10 and US$14 per million BTUs.

EXHIBITS

Exhibit 1

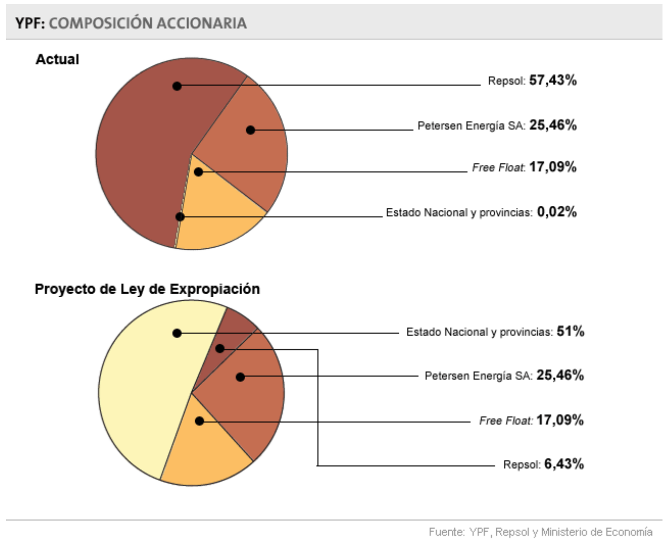


Exhibit 2a
(in Millions of U.S. Dollars)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Assets													
Current Assets													
Cash and Banks	60	26	39	248	365	492	248	118	196	391	669	570	899
Investments	20	15	71	426	961	408	426	971	655	825	1,476	1,957	562
Trade Receivables	917	1,085	948	1,913	1,992	2,049	1,913	2,242	3,235	2,702	2,831	3,322	3,473
Other Receivables	238	424	835	5,137	6,425	3,871	5,137	5,033	4,361	1,861	2,490	3,089	3,090
Inventories	249	307	274	626	974	1,134	626	1,697	2,573	3,449	3,066	3,865	6,074
Other Current Assets			139			380		1,128					
Total Current Assets	**1,484**	**1,857**	**2,306**	**8,350**	**10,717**	**8,334**	**8,350**	**11,189**	**11,020**	**9,228**	**10,532**	**12,803**	**14,098**
Long-Term Assets													
Trade Receivables	16	16	78	80	84	72	53	44	32	24	22	28	22
Other Receivables	479	526	580	1,145	1,445	1,457	1,223	852	809	945	975	1,587	989
Investments	2,832	2,769	1,370	1,049	573	490	495	788	799	848	749	594	633
Fixed Assets	7,107	7,383	8,699	18,898	20,444	20,554	21,958	22,513	25,434	28,028	27,993	31,567	39,650
Intangible Assets	52	42	150	29	32	15	5	8	8	6	12	10	7
Other Non-Current Assets					22								
Total Long-Term Assets	**10,486**	**10,736**	**10,877**	**21,201**	**22,60**	**22,588**	**23,734**	**24,205**	**27,082**	**29,851**	**29,751**	**33,786**	**41,301**
Total Assets	**11,970**	**12,593**	**13,183**	**29,551**	**33,317**	**30,922**	**32,224**	**35,394**	**38,102**	**39,079**	**40,283**	**46,589**	**55,399**
Liabilities													
Current Liabilities													
Accounts Payable (Commercial)	541	821	1,051	1,697	1,895	2,025	2,932	3,495	4,339	6,763	5,857	7,639	11,915
Loans (Banking and Finance)	1,067	579	1,097	1,529	1,049	246	346	915	471	3,219	4,679	6,176	8,113
Salaries and Social Security	51	56	61	84	102	121	153	207	213	284	298	421	569
Taxes	312	661	150	566	3,396	1,999	1,831	1,298	1,441	1,132	1,437	2,571	812
Dividends	325	311	3,632	37	2,990	5,310	4,878	2,360	4,234	6,560	4,897	4,444	5,565
Advances From Customers	89	78	151	398	260	264	95	96	9				
Forecasts	6	113	134	141	98	130	230	273	466	588	341	295	396
Total Current Liabilities	**2,144**	**2,397**	**2,644**	**4,415**	**6,800**	**4,785**	**5,587**	**6,284**	**6,939**	**11,986**	**12,612**	**17,102**	**21,805**
Long-Term Liabilities													
Accounts Payable (Commercial)	17	246	166	98	454	854	1,915	2,448	2,542	3,473	4,391	5,616	6,880

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Loans	1,991	1,291	1,151	2,728	2,096	1,684	1,107	510	523	1,260	2,140	1,613	4,654
Salaries and Social Security			50	134	119	68	56	202	164	116	110	168	181
Taxes				38	21	23	17	20	21	31	190	523	623
Advances From Customers	365	276	509	1,317	881	634	101	7					
Forecasts	78	90	181	538	537	898	1,007	1,578	1,853	1,857	1,959	2,527	2,521
Other Non-Current Liabilities					-125								
Total Non-Current Liabilities	**2,451**	**1,903**	**2,057**	**4,853**	**3,983**	**4,161**	**4,203**	**4,765**	**5,103**	**6,737**	**8,790**	**10,447**	**14,859**
Total Liabilities	**4,595**	**4,300**	**4,701**	**9,268**	**10,783**	**8,946**	**9,790**	**11,049**	**12,042**	**18,723**	**21,402**	**27,549**	**36,664**
Net Equity													
Total Net Equity	**7,375**	**8,293**	**8,482**	**20,283**	**22,534**	**22,087**	**22,546**	**24,345**	**26,060**	**20,356**	**18,881**	**19,040**	**18,735**

Exhibit 2b
(in Millions of U.S. Dollars)

Results	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Net Sales	6,578	6,219	8,162	19,599	21,172	19,931	22,901	25,635	29,104	34,875	34,320	44,162	56,697
Cost of Sales	-4,196	-3,025	-4,868	-11,057	-11,323	-9,212	-11,258	-15,821	-19,000	-24,013	-23,177	-29,899	-41,932
Gross Profit (Loss)	2,382	3,194	3,294	8,542	9,849	10,719	11,643	9,814	10,104	10,862	11,143	14,263	14,765
- Operating Expenses													
Selling Expenses	-533	-138	-771	-1,050	-1,184	-1,403	-1,650	-1,797	-2,120	-2,460	-2,490	-3,015	-3,723
Administrative Expenses	-159	-513	-218	-432	-404	-463	-552	-674	-805	-1,053	-1,102	-1,429	-1,905
Other Expenses	-175	-72	-101	-240	-281	-382	-280	-460	-522	-684	-552	-344	-574
Gains or Losses of Long-Term Investments	20	12	-116	-436	150	154	54	183	34	83	-22	79	92
Other Income and Expense	-102	-267	-126	-430	-156	-870	-570	-204	-365	-376	159	-155	-62
Financial Results													
Total Assets	54	76	4	754	-632	446	594	737	871	1,026	280	2,796	1,797
Total Liabilities	-338	-235	-315	-3,636	579	-359	-492	-283	-353	-1,200	1,522	-1,375	-2,144
Income Tax	-378	-828	-706	-415	-3,293	-3,017	-3,410	-2,801	-2,758	-2,558	-2,408	-3,230	-2,950
Gain (Loss) for the Year	**477**	**2,057**	**819**	**3,344**	**4,628**	**4,876**	**5,337**	**4,515**	**4,086**	**3,640**	**3,486**	**5,790**	**5,296**

Exhibit 2c

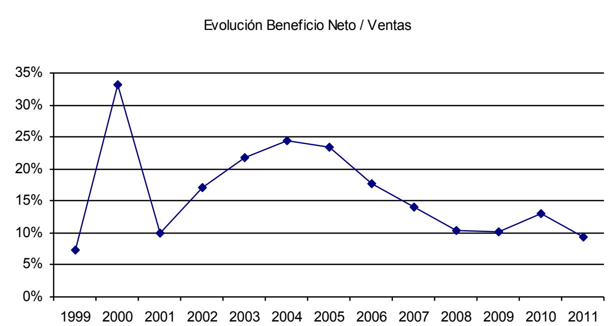


Exhibit 2d

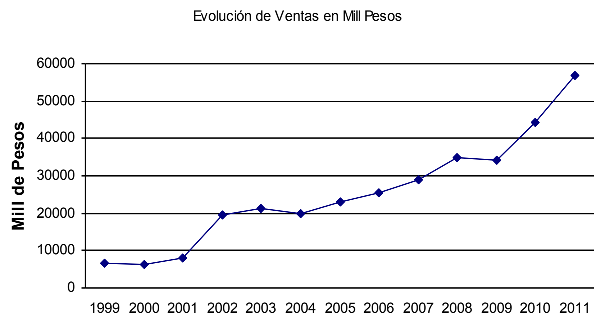


Exhibit 3a

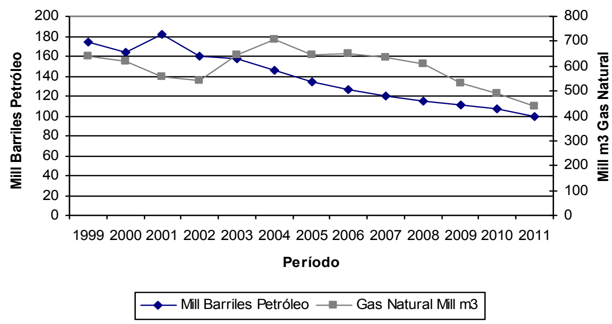


Exhibit 3b

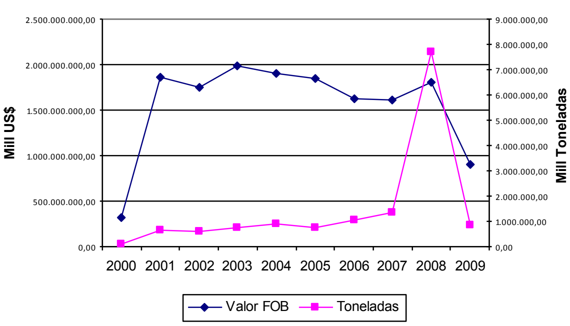


Exhibit 4

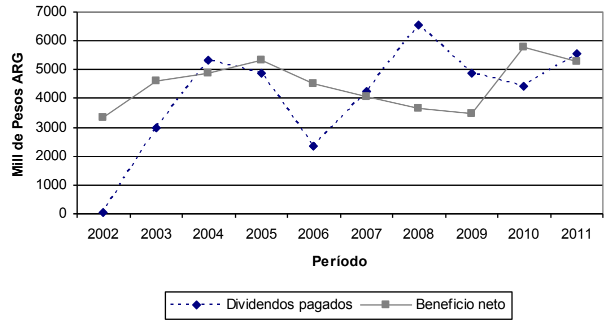


Exhibit 5

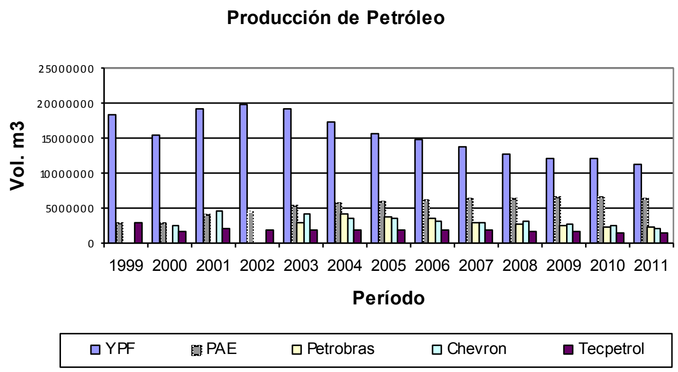


Exhibit 6a

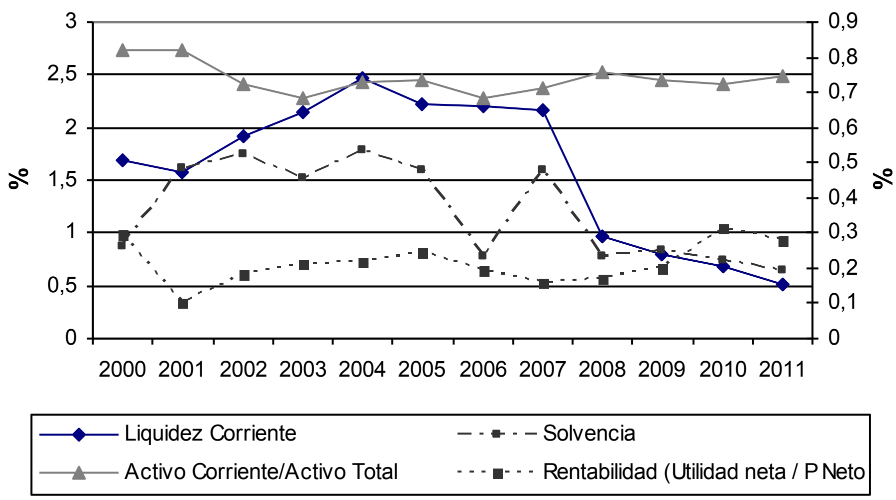


Exhibit 6b

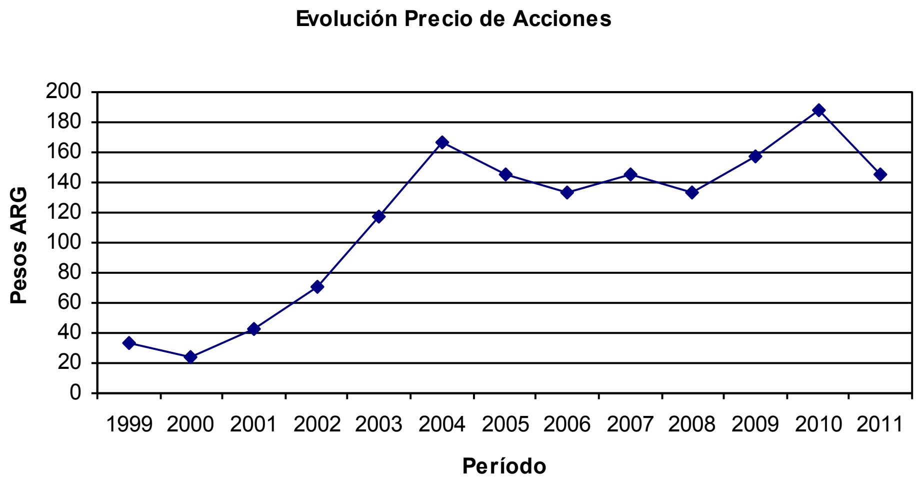


Exhibit 7[3]

This report compiles the results of the investigation conducted from April 16, 2012 to June 1, 2012 by the team that placed YPF under government control, which was led by the Comptroller, Mr. Julio De Vido, and the Deputy Comptroller, Mr. Axel Kicillof. The purpose of this document is to provide evidence on the strategy of depredation, disinvestment and failure to appropriately supply the domestic market implemented by the Repsol Group since it took control over YPF in 1999. Such strategy was evidenced as from 2003, when the effects of the neoliberal policies adopted during the three previous decades started to be offset in Argentina through the

[3] YPF- THE MOSCONI REPORT: INTRODUCTION (PP: 3-4) : <<http://www.mrecic.gov.ar/portal/ver_adjunto.php?id=4404>>

implementation of the model of economic growth with social inclusion.

The findings of this investigation conclusively prove the arguments presented in the message sent by the Executive Branch to the Argentine Congress on April 16, 2012, together with the bill that was subsequently enacted as Law No. 26,741. Government control of the Company made it possible both to obtain information that would not have been available otherwise and to channel the company's policies in accordance with the energy-related needs of Argentina, thus putting an end to the strategy of depredation, disinvestment and failure to appropriately supply the market implemented by the abovementioned control group and also preventing any kind of ploy by such group. This report shows that:

a. The Repsol group used YPF to support and finance its strategy for global expansion, thus predating Argentina's oil and gas resources with a short-term vision that gave priority to the transfer of dividends to its headquarters over the exploration and exploitation activities characteristic of the best practices of the oil business.

b. This strategy was deepened when, as from 2003, Argentina began to walk the path of reindustrialization and rapid economic growth in which oil once again became an essential strategic resource and its price became a core element in the economy, as being a fundamental lever of the country's systemic competitiveness. The inconsistency between the evolution of domestic hydrocarbon prices and their international parity led, under Repsol's management, to the gradual abandonment of YPF's exploration and exploitation activities within a context of increasing international prices.

c. Soon after acquiring YPF, Repsol began a systematic process of underinvestment in Argentina with the express goal of "reducing its exposure to risk in this country". However, as a result of the convergence of an upturn in international prices and the development of new technologies, the exploitation of the so-called "unconventional resources" present in the Vaca Muerta field became profitable. In the face of this scenario, instead of seeking to improve its performance in terms of production, the Repsol group started to "delineate" the Vaca Muerta field with a view to quantifying its potential in order to dispose it at a later time, either through a sale or subconcession. This new strategy by Repsol further hindered investments in conventional resources, since the financial resources that entered Argentina were mostly used to investigate the unconventional resources that they intended to transfer to third-parties.

Hence, the strategy implemented by the Repsol Group as regards YPF may be summarized as follows:

1. Reduction of investments in the expansion of production to focus exclusively on extracting oil from already discovered fields, which was evidenced by the systematic decline of the Company's oil and natural gas production .

2. Interruption of all the projects aimed at increasing natural gas production since the yield was lower than the ones obtained by the company in other international businesses.

3. Liquidation of international assets and companies that YPF had acquired during its previous development.

4. Delineation of Vaca Muerta with a view to selling the business or partnering with a third party that might contribute capital, rather than investing and increasing production.

5. Gathering of as many short-term resources as possible to finance the global expansion and productive diversification of the Repsol Group to the detriment of YPF and the

hydrocarbon needs of Argentina.

In order to prove the above statements, this report has been structured as follows. The first section describes the international strategy of the Repsol Group so as to provide a comprehensive framework to analyze its local operations in YPF. The second section describes the policies involving depredation, disinvestment and undersupply the market implemented by the Repsol Group during its management of YPF. The third section shows how this strategy was deepened as from the technical changes and price increases that caused the exploitation of the unconventional resources in Vaca Muerta to become profitable. The fourth and last section summarizes the main conclusions in the report and introduces the main goals and challenges to be faced by the new YPF, in which the government is a majority shareholder.

CASE B: THE EXPROPRIATION OF REPSOL-YPF (SPANISH VERSION)

YPF: An "Illegal" Expropriation

"The expropriation of YPF will not go unpunished."

Antonio Brufau, Repsol chairman

A sense of ratified injustice pervaded the Repsol executives, including its chairman, Antonio Brufau, when, on the mid-afternoon of April 16, rumors that had been coming from Argentina were confirmed.

It is noon in Argentina. At the Casa Rosada in Buenos Aires, the presidential palace, the head of state, Cristina Fernández de Kirchner, is surrounded by governors and business leaders close to the party. In the midst of an epic speech, she confirms that she will carry out the expropriation of YPF, Repsol's oil subsidiary.

In her very rehearsed and histrionic remarks—she even makes a veiled allusion to the king of Spain—she announces that the state shall declare 51% of the shares belonging to Repsol-YPF as belonging to the public and subject to expropriation. Of that percentage earmarked for expropriation, 51% would go in to the hands of the national government and the other 49% would be controlled by the 10 oil-producing provinces. The government will thus have a 26.01% stake, and governors will end up with 24.99%. All shares are expropriated from Repsol and none from the Argentinian Petersen Group, owned by the Eskenazi family, which owns 25.46% of Repsol-YPF.

The announcement triggers a roar of applause, and the contained euphoria of the governors and other Argentinian public figures explodes. Minutes later, the announcement causes a turbulent wave of reactions and events, which, in Spain, are viewed with disbelief by all strata of society. Politicians, business leaders and many friends having coffee react in unison against what is considered by virtually all society as an affront to the interests of Spain, not only to those of a company.

Spanish television shows clips from the speech, and the news crosses the thousands of miles between Buenos Aires and Madrid in a matter of seconds. At four in the afternoon in Argentina, five hours later in Madrid, there is a frenzy of activity. Several government officials arrive at the intersection of the Macacha Güemes and Juana Manso streets in the Buenos Aires neighborhood of Puerto Madero—what had been, until this moment, the headquarters of Repsol-YPF in Argentina—led by the Argentinian government representative within Repsol-YPF, Roberto Baratta, with a list of names of people to be removed immediately. Government envoys led by Baratta "invite" Spanish executives to "pack their boxes" immediately and step outside. Among the first to step out is Spanish manager Antonio Gomis, CEO of Repsol in Argentina and deputy vice president of YPF since February 2010.

While in Spain, even among some members of Repsol, the news was unexpected, for executives in Argentina it came as more of a confirmation than a surprise. They had been denouncing the Argentinian government's "harassment" of the Spanish company for months. The truth is that this impression began to congeal a few months earlier, in December 2011, when the Casa Rosada sent documents to Repsol's headquarters warning that they weren't investing enough to increase production.

Skepticism and disbelief took over those present. They considered this claim to be inaccurate, so they alerted Madrid of this development, and the Spanish parent company began to address the real risk, which would later be announced by the president. Quantitatively speaking, the Spanish company had invested over US$20 billion between 1999 and 2011.

Days pass, and it's now January 2012. The workday is progressing normally at the Repsol headquarters when, without warning, Argentinian government tax inspectors show up without prior notice. After requesting documents and upsetting the company's business pace, they decide to open dozens of administrative records at random. Now the threat of expropriation is looming.

In successive days, five governors from the 10 oil provinces began to return contracts to the company. In this situation, Antonio Brufau, chairman of the Spanish company, decided to immediately fly to Buenos Aires to take command of the situation, after trying, unsuccessfully, to get through to the president of Argentina. Nonetheless, Brufau's office continues to receive draft bills without any signature or letterhead, in which the expropriation of the company is considered. However, the government does not claim responsibility for them. During these weeks of uncertainty and rumors, the Argentinian government's veiled threat to expropriate the Spanish company pushed its stock market value down on Wall Street. Upon confirmation, with overwhelming support from Spanish authorities and businessmen, shares fell more sharply.

There is no denying that in the years prior to the YPF takeover, Argentina's economic environment showed symptoms common to Latin American countries: an increasing deterioration in external accounts due to a substantial increase in imports, capital outflows and average annual inflation rates of 25%. More than 60% of Argentinian exportable supplies come from commodities and derivatives. Surprisingly, the energy sector has also shown external balance sheet deficits since 2009 (see Exhibit 1a). It seems that to address these issues, mainly for aesthetic reasons, the decision was made to confront the ancient metropolis.

Upon the delivery of the speech, a dispute began about fair compensation for the Repsol group. The Argentinian government said it would not pay the compensation claimed by Spanish company Repsol, as, in its opinion, the Spanish group had already recovered more than enough of what it invested during the years it had owned YPF. Argentina's deputy economy minister said that, as required by Argentinian expropriation law, the share price would be set by the country's Tax Courts. Repsol has not been able to negotiate diplomatically with the Argentinian government about the compensation due for expropriation, since, as in most Latin American countries, the Calvo Doctrine[4] holds sway. The Calvo Doctrine stipulates that parties residing in foreign countries are subject to the jurisdiction of local courts, not diplomatic or military pressure from their home countries. It also underscored that, before paying, the environmental damage caused in various areas operated by YPF would have to be taken into account.

The chairman of Repsol has demanded compensation in the amount of US$10.5 billion, plus expenses. Faced with the Argentinian government's refusal to negotiate the value of the company, Antonio Brufau confirmed that his company would sue Argentina at the ICSID (International Centre for Settlement of Investment Disputes), the World Bank tribunal for investment treaty cases.

The expropriation of companies was unprecedented in Argentina under prior governments. In fact, in the nineties, under the presidency of Carlos Menem and his economy minister, Domingo Cavallo, the country (like most Latin American countries) saw a wave of privatization of 90% of state enterprises to reduce and refinance public debt, and also help introduce technology into

[4] The Calvo Doctrine, named after its author, Carlos Calvo, establishes that those living in a foreign country should submit their lawsuits, and any claim or complaint, to the jurisdiction of local courts, avoiding recourse to diplomatic pressure. It is embedded in the constitution of several Latin American countries.

industrial sectors. The government of former President Néstor Kirchner, the deceased husband of the current president, flipped this policy on its head.

YPF + Repsol = Repsol-YPF: The Argentinian Company

YPF is a company dedicated to the exploration, exploitation, distillation, distribution and sale of oil and related products. It was founded in the early 20th century as a state company, and became the first major vertically integrated oil company in the world. It is the largest company in Argentina, directly or indirectly employing more than 46,000 people. In 1992, when it ceased to be profitable, YPF was privatized by the Argentinian government, and Repsol entered the scene in 1998.

The Argentinian government sold Repsol 14.99% of YPF shares, and Repsol staged a takeover bid for the rest of the capital. The transaction cost the Spanish oil company €13.44 billion, and allowed Repsol to become the eighth largest oil producer and the 15th largest energy company in the world. The Argentinian government received income from the privatization of YPF, between 1992 and 1999, to the tune of US$20.27 billion, of which US$15.17 billion were for Repsol's acquisition in 1999.

In 2008, President Néstor Kirchner forced Repsol to include Argentine partners in the company. Enter the Petersen Group, owned by the Eskenazi family, who "bought" 25% of the shares.

By December 31, 2011, the Petersen Group owned 25.46% of YPF, Repsol held 57.43%, the remaining 17.09% was held by private investors on the stock exchange, and 0.02% was held by the Argentinian government, who retained the golden share. Interestingly, the Kirchner couple was one of the staunchest supporters of Repsol's purchase of YPF in 1998.

YPF: Stock Ups and Downs

YPF is the leading energy company in Argentina, the largest producer of hydrocarbons and refined products, the largest investor, and one of the largest generators of employment (more than 46,000 people are employed directly or indirectly by the company). YPF's Board consisted of 17 directors—five of whom were independent—and included a government representative. The number of directors was considered appropriate for the company's sphere. It seeks profile diversity and experience in its Board members.

YPF's operations involve exploration, development and production of crude oil, natural gas and LPG (liquefied petroleum gas). Downstream operations (marketing and processing) include the refining, sale, transportation and distribution of oil and a wide range of petroleum products (especially petrochemicals and liquefied petroleum gas) and biofuels. It is also active in gas separation and natural gas distribution, both directly and through its investments in various subsidiaries.

In 1992, during the government of Carlos Menem, YPF was privatized through law 24,145: Yacimientos Petrolíferos Fiscales was an Argentinian state-owned company that became YPF S.A. The government granted the company privileges to increase its value in the market and the private sector, made up of banks and investment funds from various countries, which increased its share in the company.

In 1999, the Repsol Group acquired 85.01% of the company's shares for US$13.44 billion.[5] Although the Iberian bid met with initial resistance from shareholders, the Board recommended acceptance of the proposal. The oil and gas company based in Spain has operations in the energy sector worldwide. Repsol controlled 99% of YPF's shares from 2000 to 2008. That last year, the

[5] In late 1998, Repsol acquired 5.01% of the government's shares, and in early 1999, it purchased the remaining 14.99% for US$2.01 billion. In June 1999, Repsol bought 55% of YPF and 11% of the provinces, reaching almost 90% of all company shares.

Argentinian Petersen Group acquired 14.9% of Repsol-YPF, paying US$100 million with its own equity and taking funding from private banks and Repsol to acquire the entire stake, which was valued at US$2.24 billion. The remaining US$1.02 billion came from a pool of banks formed by Credit Suisse, Goldman Sachs, BNP Paribas and Banco Itaú. In 2011, the Petersen Group increased its stake in YPF with the purchase of 10% more shares for a total of US$1.3 billion, taking ownership of 25.46% of the oil company. The arrangement was similar: a consortium of several banks (Banco Itaú, Santander, Standard Bank, Credit Suisse and Citi) contributed US$670 million and Repsol put forward a similar amount. Since September 2010, Repsol YPF has sold approximately 16.57% of the company on the stock market. As of September 30, 2011, Repsol-YPF controlled 57.43%, the Petersen Group owned 25.46% and the remaining shares were free-float, traded on the NYSE and Buenos Aires Stock Exchange (see **Exhibit 1b**).

Company Results

Since its acquisition in 1999, Repsol management has demonstrated successful financial and operational management (see **Exhibit 2a** and **2b**). During the 1999 – 2011 period, sales increased annually by 24% on average, resulting in an average 16% net profit on sales per year. However, profit on sales has dropped since 2004 (see **Exhibit 2c** and **2d**).

This reduction is caused by the increased cost of sales due to more crude purchases from other producers and higher prices (about 22% in pesos) as a result of price adjustments between local producers and refiners, taking into account the exchange rate hike effect (since they are set in dollars). There were also increased imports of low-sulfur diesel fuel intended for manufacturing premium diesel fuel and standard car oil. This was done to meet the higher demand for these products in the local market and also comply with applicable regulatory requirements in this area. It should also be highlighted that in 2011, biofuel prices and sales volumes were increased (especially biodiesel and bioethanol) in order to include liquid fuels, in compliance with the provisions in force.

Investment, Production and Sales

Despite strong sales, the company's production of oil and gas barrels has dropped (see **Exhibit 3a**), something which, according to company sources, was a logical optimization of existing resources. From the investment point of view, and specifying the already cited US$20 billion amount, those made in recent years stand out particularly for being especially generous: US$1.36 billion in 2009, US$2.16 billion in 2010 and US$3.26 billion in 2011. In any case, all of them are far superior to those made to the second and third operators in the country.

The oil industry has received a boost in recent years from the increase in international prices. Despite the global economic outlook, it has seen an upward trend in 2011, primarily due to the reduction of inventories in the United States, as well as geopolitical problems, especially in the major producing countries, affecting oil barrel price. Average exports in oil and derivatives, in FOB prices, started to nosedive after the economic crisis in Argentina in 2001. Exports measured in tons have shown an average annual increase of 6%. These results demonstrate the impact of the domestic market and international prices on increasing the company's sales. The average Brent crude barrel price was US$111.26 in 2011, US$79.61 in 2010 and US$61.74 in 2009.

The use of funds for investing and financing activities are geared towards the exploration and production business, refining, marketing, chemicals and central administration. In 2011, approximately 67% was allocated to the business of exploration and production, 23% for refining and marketing, 8% to chemicals and 2% to central administration and others. In 2010, approximately 70% was allocated to the business of exploration and production, 20% for refining and marketing, 8% to chemicals and 2% to central administration and others. In 2009, 74% was allocated to the business of exploration and production, 20% for refining and marketing, 3% to chemicals and 3% to central administration and others.

Dividend Policy

Following the agreement signed in late 2007 between Repsol-YPF and the Petersen Group, promoted by former President Néstor Kirchner, the parties agreed to a dividend policy that proved satisfactory to both. It also contributed to giving the company's shares appeal in the markets in terms of an appropriate relationship between dividends and earnings (payout). To this end, they agreed to distribute (in two yearly installments) 90% of the company's profits as dividends. The stock purchase agreement stipulates that the Petersen Group pay for its share with what it receives as dividends. Thus, the dividend policy in some periods has exceeded the total net profit (see **Exhibit 2d**), just as the government of Argentina had warned. This warning was unnecessary, according to Repsol, since it had just allowed the agreement to unfold naturally.

Indeed, paradoxically, the expropriation resulted in the Petersen Group not receiving the dividend payout that enabled it to repay its debt. Spanish financial press headlines did not fail to notice: "Repsol recovers 6% of YPF after Petersen Group defaults." So, after notification of nonpayment of the debt owed by the Petersen Group to the Spanish oil company and various banks, to reach 25.46% of YPF, Repsol has taken up political rights of another 6% of YPF capital, a percentage constituted as collateral for its loans to the group.

Added to the percentage of YPF not expropriated (6% of its 57% total, since 51% was expropriated), Repsol now has a 12% stake in YPF and will continue to negotiate for a fair compensation for the expropriation. This news, on the other hand, had no impact on share price, considering that the loan to the Petersen Group (€1.54 billion) is valued at zero.

Expropriation of the Company

The news provoked an avalanche of statements from all areas: society, the Spanish government, Repsol management and even the European Union (EU).

Reactions in Spanish Society

The best summary of what happened in Spain can be seen in these government remarks in a statement issued hours after the Argentinian announcement: “All hostility against our companies is hostility against Spain.” The truth is that once radio and television headlines flooded Europe, the Argentinian government’s bombshell created a wave of outrage and disbelief in Spanish society.

At media headquarters phones rang off the hook, staff work tirelessly, sought reactions, statements and news headlines on the issue. Headlines went up on cover pages and online news sites offered minute-by-minute updates. The social tension in the Spanish streets was palpable. In cafés, on the subway and anywhere in the Spanish territory, everyone was talking about the same thing: the Argentinian government’s “theft” of the Spanish company. Everyone waited for a reaction from the Spanish government.

Reactions from the Spanish Government

It did not take long in coming. Spain’s prime minister, Mariano Rajoy, appeared at a press conference in Mexico, where he was taking part in an economic forum. The official reaction warned that “any act of hostility anywhere in the world against Spanish companies will be interpreted as a gesture of hostility against Spain and against its government that will have consequences.” The prime minister added that the action “significantly affects Argentina’s international reputation.”

Rajoy also underscored that his government would work “with intensity and perseverance” to defend Repsol’s interests and the model of economic and trade relations based on “mutual respect between countries.” The government prepared retaliatory measures that would be approved that Friday in the Council of Ministers, and made efforts for the EU to lodge a complaint with the World Trade Organization (WTO) against Argentina. The prime minister also noted that the Spanish government “protects the interests of all Spanish companies inside and outside the country.”

In a leading article, the *El País* newspaper highlighted that “the Argentinian government’s clash with Repsol-YPF threatens to become a real, first-rate diplomatic conflict. The Spanish government has so far been discreet, although it did try to mediate with a trip by Industry Minister José Manuel Soria to Buenos Aires. Even the king of Spain has tried to defuse the conflict. Repsol chairman, Antonio Brufau, traveled to Buenos Aires several times to try to find a solution. But everything has been futile.” The *El Mundo* newspaper entitled an article: “Six weeks of harassment and demolition,” in which it spelled out the final stages of the conflict.

“It’s a drastic decision that threatens our investment abroad,” said secretary of state budget and expenditure, Marta Fernández. “Spain has made a very firm commitment to the internationalization of its businesses.”

The government, however, being everyone’s government, does not forget the interests of other Spanish companies in Argentina and is therefore cautious in all its actions and statements.

Repsol Reactions

The conglomerate of directors in the Spanish company led by its chairman, Brufau, branded as “illegitimate” the expropriation of most of the oil company’s YPF shares. A few hours after the Argentinian announcement, and anticipating whatever Rajoy would do, Brufau appeared at a press conference at the company's headquarters in Madrid to present the facts and detail the measures that the company would adopt.

During the press conference, Brufau explained how this expropriation had been a campaign orchestrated and conducted by the Argentinian government, aimed to knock down the company's share value on the stock exchange. Just to get an idea, on the day Brufau held his news conference, Repsol stock lost 7% of its value on the Spanish stock market. Its value had already dropped by 5% at about 9:45 a.m. when Brufau appeared in the news room of his company headquarters. According to him, the whole campaign orchestrated by the Argentinian government had a single purpose: to take over the majority of YPF shares at a bargain price.

Brufau also detailed the measures to be taken by the company, asserting that the Spanish oil company would undertake legal actions against the nationalization of most of the shares making up the capital of YPF. It also announced they would resort to international arbitration and would call for quick compensation of expropriated shares, at least for the same value as shareholders were entitled to in accordance with the law, which the company stipulates at US$46.55 per share, which implies valuing YPF at US$18.3 billion.

Reactions in the European Union

The European Commission reacted quickly and called Argentina's expropriation of YPF, the subsidiary of Spain's Repsol, "illegal," announcing that it would consider "all available options" to retaliate against this decision.

As a first step, Brussels decided (as requested by Spain) to adjourn the meeting of the cooperation committee between the EU and Argentina, a forum created in the economic agreement of 1990 which addresses bilateral relations.

“We understand that this expropriation is illegal to the extent that it takes place without adequate, fair and expeditious compensation,” said Commission Spokeswoman Pia Ahrenkilde. The EU Trade Commissioner Karel de Gucht also expressed the EU’s “serious concerns” on this matter in a letter to his Argentinian counterpart.

“Due to the climate that has been created by the situation, the EU Commission has decided to postpone the EU-Argentina joint committee which was to meet on 19 and 20 April,” said the spokeswoman, who eluded revealing what the possible options were. She did, however, recall that the Lisbon Treaty makes the protection of community investments abroad the “exclusive competence” of the EU. A headline in the morning newspaper stated: “European Commission President José Manuel Durão Barroso is ‘seriously disappointed’ with the announcement of Argentina’s president to nationalize 51% of YPF in Repsol’s hands, and called for Argentina to honor its international commitments and bilateral agreements with Spain.”

Moreover, Barroso called on community services to follow the matter closely and also give it “top priority.”

Moreover, the EU trade spokesman, John Clancy, warned Argentina that the expropriation of 51% of the share capital of YPF, controlled by Spanish energy company Repsol, would send a “very negative” signal to investors and could seriously damage the business climate in the country. He was ignored. For its part, the European Commission said it was “on the side of Spain” in this dispute with Argentina, but acknowledged that the EU currently has no legal mechanisms to pressure the Latin American country to meet its commitments in connection with investments by EU countries in its territory.

Company Valuation: Crosshairs of the Conflict

The estimated value of Repsol's stake in YPF would be US$46.55 (€35.11) per share, making the total value of the company US$18.3 billion (approximately €13.76 billion). The Spanish oil company planned to sue Argentina in international courts for at least US$10.5 billion for the expropriation of YPF, accounting for 57.4% of the value Repsol had in YPF before expropriation. "We will sue Argentina in court for at least US$10.5 billion after the expropriation, but if we can we will ask for more," reiterated the chairman of Repsol. And he did exactly that, taking the case to all possible courts, including the Argentinian Constitutional Court on June 12, 2012.

Background of Recent Expropriations in Argentina

In 2006, after long and fruitless negotiations between the government and the French group Suez, former President Néstor Kirchner decided to terminate the concession contract of Aguas Argentinas and create a state company. The government accused Aguas Argentinas of failing to comply with the agreed upon works plan for expansion and improvement of the service, and endangering the health of the population by the level of nitrates found in certain places. The company, however, rejected the government's allegations, and stressed that during its operation, two million people were given access to drinking water, and one million more to sewage services, highlighting that it invested US$1.7 billion. The ICSID ruled in favor of Suez Environnement and GDF Suez. It also ruled in favor of Aguas de Barcelona (AGBAR), which owned the water concession in the province of Santa Fe.

The management experiences of other Argentinian government expropriations are not too encouraging. In 2008, Aerolineas Argentinas was expropriated, which was held by Spanish group Marsans, with arguments similar to those wielded for the expropriation of Repsol shares.

The management of the company is in the hands of government policy makers, and the early years of administration have proven to be a failure. In the first year, it needed a US$332 million government injection. The following year, in 2009, the figure climbed to US$612 million. In 2010, after a full calendar year of management, the assistance needed was US$575 million, of which US$38 million was earmarked for the purchase of new aircraft. In 2011, it received US$757 million, slightly less than US$2 million per day. Government management of the company resulted in daily losses which much worse than when it was managed by the Spanish group.

Background of Expropriations in Latin America

"We are concerned by the Bolivian government's decision and announcement to nationalize the Spanish-owned electricity company. This comes on the heels, obviously, of the Argentine announcement," said U.S. State Department spokesman Mark Toner.

Bolivia's president-elect for his second term in 2005, Evo Morales, has aligned with peers Hugo Chávez, Rafael Correa and Fidel Castro (Venezuela, Ecuador and Cuba, respectively) to take a critical stance towards international companies operating natural gas contracts signed with previous governments since 1990. In early 2006, he took oil assets by military force and increased natural gas export prices to Brazil, which is the consumer of 75% of production and whose exploitation was in the hands of Petrobras. The Brazilian oil company was the largest investor, producer and consumer of Bolivian oil. Brazil's President Lula da Silva responded diplomatically, accepting the fact and affirming that "Bolivia needs to sell natural gas to Brazil, and Brazil needs natural gas from Bolivia... So there will be a reasonable deal for both sides."

Expropriations have been one of the hallmarks in the Venezuelan government of Hugo Chávez. According to regional figures, Venezuela has seen 2,179 cases of asset seizures and encroachments since 2005. The state-owned Petróleos de Venezuela (PDVSA) paid US$250 million to the U.S. company Exxon Mobil as compensation for its assets nationalized in 2006. Exxon Mobil sued Venezuela for US$12 billion, but the International Chamber of Commerce ruled that the country should only pay US$908 million. After discounts, according to the Venezuelan government, it only deducted that which had been canceled.

Moody's, the credit rating agency, has forecasted that, given the emerging social and political pressures, new expropriations cannot be dismissed in countries with weak institutional frameworks, such as Venezuela, Argentina and Bolivia. It does deny, however, that the recent nationalization of Repsol-YPF and Transportadora de Electricidad (TDE) in Bolivia are a harbinger of a trend in Latin America. The nationalizations in Bolivia and Argentina are perceived as confirmation of a growing differentiation between Latin American governments with strong credit profiles and favorable investment climates and those where these elements are not present.

The Mercosur Chambers of Commerce expressed concern over the expropriation of companies in the region and felt that this change of rules affects FDI, urging governments to comply with the provisions for fair and proper compensation. For Brazil's National Trade Confederation, the business climate is being affected by some measures taken mainly by Argentina.

Challenges: The Challenge for Repsol and the Spanish Government

Rarely has a company that has suffered an expropriation as major, in economic terms, as Repsol's been gingerly sidestepped by international appraisal companies like the Spanish oil company was. It is true that all the investment houses have lowered their rating on the company, with target price cuts of over 20%; but it could not be otherwise, given that in 2011, YPF accounted for 21% of its net profit, according to data from the parent company, and it corresponded to 50% of the reserves. Add to this the loss of the Vaca Muerta mega-site, in southwestern Argentina, initially valued at €13.7 billion, but potentially much greater. This, together with a share value well below that assigned by all agencies and banks, made it an interesting company to invest in, in the long term, of course. The directors of the company, however, have to work with care.

Confirmation has also been received that they have lost the US$1.9 billion (€1.45 billion) loan granted to the Petersen Group, led by Enrique Eskenazi, which in late 2007 was able to obtain 25.46% of YPF. Contrary to what was expected, the Petersen Group's share has not been affected and the nationalization of 51% only concerned Repsol's 57.4% holding. Eskenazi defrayed the loan with YPF dividends (Repsol received about €550 million per year from this loan), and the Argentinian government has already announced that dividend payments will end. Therefore, Repsol now owns 12%, not just the little more than 6% it was left with after the expropriation. Still, while it has two proposed directors on the YPF Board, it no longer controls them directly. It has to consider what to do with its share and with the many contingencies it's sure to encounter along the way.

So, for that potential to be realized, several issues need to be cleared up. For starters, what will happen to the dividend in future years? And then Repsol announced a legal battle against at the ICSID for Argentina to pay compensation for the 51% stake that Repsol lost, i.e., more than US$10.5 billion (just over €8 billion). But this is a matter that can take several years to be resolved. The Barclays forecast is among the most optimistic. It calculates a period of two years and US$3.5 billion in compensation. Most value the entire Argentina subsidiary (let's not forget that Repsol retained 6%, which is now 12%, of YPF after the expropriation) at zero. Repsol has also filed claims in the Argentinian courts. It filed an appeal of unconstitutionality before the Constitutional Court of Argentina, not to mention the diplomatic channel.

In this respect, diplomacy and the Spanish government, which at an early stage staunchly defended the oil company, have gradually contained their demeanor without throwing down the towel for what they believe is an injustice. But they are forced by other Spanish interests in the country (see **Exhibit 7**) and in international politics to soften their stance. Their position is in fact rather complex. They have to be able to not burn their tires on what seems to be a lost cause but without setting a precedent for other Spanish companies in Argentina and Latin America in general, such as the expropriation of the Spanish Electricity Network (REE) affiliate in Bolivia, although that was a different operation. Open defense of the economies of Spanish companies is made in all kinds of forums, as has been done, while relinquishing the benchmark position in the Latin American economy. In any case, this is a complex situation for Repsol management and the Spanish government, who have acted so far with a certain degree of caution.

Exhibit 1

Exhibit 1a External Fuel Balance (in Millions of U.S. Dollars)

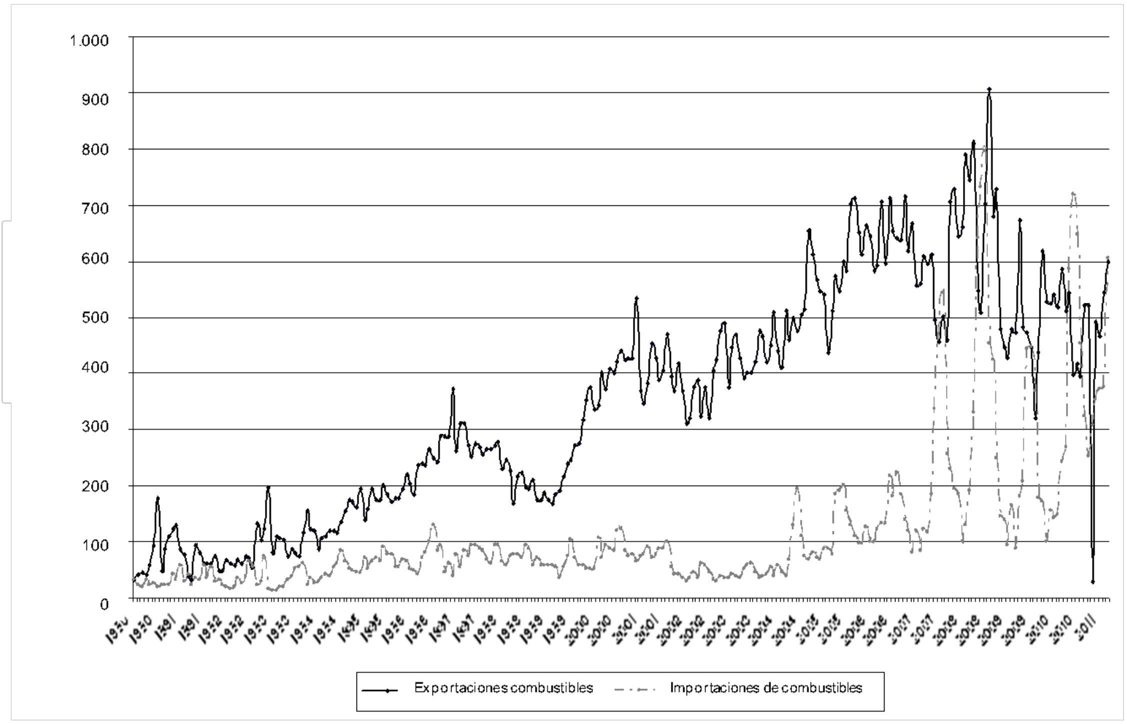
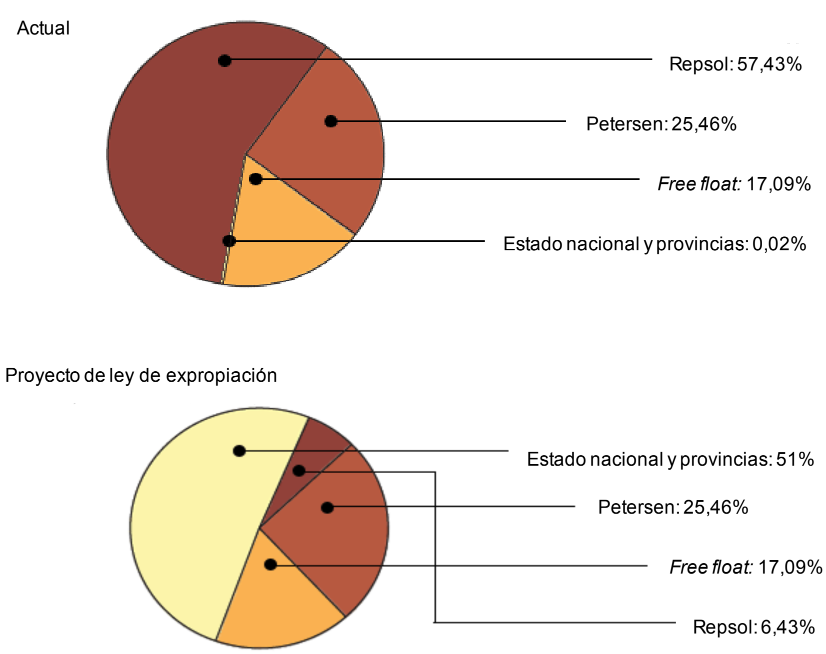


Exhibit 1b YPF: Stock Composition



Source: YPF, Repsol and Ministry of Economy.

Exhibit 2

Exhibit 2a (in Millions of U.S. Dollars)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Assets													
Current Assets													
Cash and Banks	60	26	39	248	365	492	248	118	196	391	669	570	899
Investments	20	15	71	426	961	408	426	971	655	825	1,476	1,957	562
Trade Receivables	917	1,085	948	1,913	1,992	2,049	1,913	2,242	3,235	2,702	2,831	3,322	3,473
Other Receivables	238	424	835	5,137	6,425	3,871	5,137	5,033	4,361	1,861	2,490	3,089	3,090
Inventories	249	307	274	626	974	1,134	626	1,697	2,573	3,449	3,066	3,865	6,074
Other Current Assets			139			380		1,128					
Total Current Assets	**1,484**	**1,857**	**2,306**	**8,350**	**10,717**	**8,334**	**8,350**	**11,189**	**11,020**	**9,228**	**10,532**	**12,803**	**14,098**
Long-Term Assets													
Trade Receivables	16	16	78	80	84	72	53	44	32	24	22	28	22
Other Receivables	479	526	580	1,145	1,445	1,457	1,223	852	809	945	975	1,587	989
Investments	2,832	2,769	1,370	1,049	573	490	495	788	799	848	749	594	633
Fixed Assets	7,107	7,383	8,699	18,898	20,444	20,554	21,958	22,513	25,434	28,028	27,993	31,567	39,650
Intangible Assets	52	42	150	29	32	15	5	8	8	6	12	10	7
Other Non-Current Assets					22								
Total Long-Term Assets	**10,486**	**10,736**	**10,877**	**21,201**	**22,60**	**22,588**	**23,734**	**24,205**	**27,082**	**29,851**	**29,751**	**33,786**	**41,301**
Total Assets	**11,970**	**12,593**	**13,183**	**29,551**	**33,317**	**30,922**	**32,224**	**35,394**	**38,102**	**39,079**	**40,283**	**46,589**	**55,399**
Liabilities													
Current Liabilities													
Accounts Payable (Commercial)	541	821	1,051	1,697	1,895	2,025	2,932	3,495	4,339	6,763	5,857	7,639	11,915
Loans (Banking and Finance)	1,067	579	1,097	1,529	1,049	246	346	915	471	3,219	4,679	6,176	8,113
Salaries and Social Security	51	56	61	84	102	121	153	207	213	284	298	421	569
Taxes	312	661	150	566	3,396	1,999	1,831	1,298	1,441	1,132	1,437	2,571	812
Dividends	325	311	3,632	37	2,990	5,310	4,878	2,360	4,234	6,560	4,897	4,444	5,565
Advances From Customers	89	78	151	398	260	264	95	96	9				
Forecasts	6	113	134	141	98	130	230	273	466	588	341	295	396
Total Current Liabilities	**2,144**	**2,397**	**2,644**	**4,415**	**6,800**	**4,785**	**5,587**	**6,284**	**6,939**	**11,986**	**12,612**	**17,102**	**21,805**
Long-Term Liabilities													
Accounts Payable (Commercial)	17	246	166	98	454	854	1,915	2,448	2,542	3,473	4,391	5,616	6,880
Loans	1,991	1,291	1,151	2,728	2,096	1,684	1,107	510	523	1,260	2,140	1,613	4,654
Salaries and Social Security			50	134	119	68	56	202	164	116	110	168	181
Taxes				38	21	23	17	20	21	31	190	523	623
Advances From Customers	365	276	509	1,317	881	634	101	7					
Forecasts	78	90	181	538	537	898	1,007	1,578	1,853	1,857	1,959	2,527	2,521
Other Non-Current Liabilities					-125								
Total Non-Current Liabilities	**2,451**	**1,903**	**2,057**	**4,853**	**3,983**	**4,161**	**4,203**	**4,765**	**5,103**	**6,737**	**8,790**	**10,447**	**14,859**
Total Liabilities	**4,595**	**4,300**	**4,701**	**9,268**	**10,783**	**8,946**	**9,790**	**11,049**	**12,042**	**18,723**	**21,402**	**27,549**	**36,664**
Net Equity													
Total Net Equity	**7,375**	**8,293**	**8,482**	**20,283**	**22,534**	**22,087**	**22,546**	**24,345**	**26,060**	**20,356**	**18,881**	**19,040**	**18,735**

Exhibit 2 (Continued)

Exhibit 2b (in Millions of U.S. Dollars)

Results	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Net Sales	6,578	6,219	8,162	19,599	21,172	19,931	22,901	25,635	29,104	34,875	34,320	44,162
Cost of Sales	-4,196	-3,025	-4,868	-11,057	-11,323	-9,212	-11,258	-15,821	-19,000	-24,013	-23,177	-29,899
Gross Profit (Loss)	2,382	3,194	3,294	8,542	9,849	10,719	11,643	9,814	10,104	10,862	11,143	14,263
- Operating Expenses												
Selling Expenses	-533	-138	-771	-1,050	-1,184	-1,403	-1,650	-1,797	-2,120	-2,460	-2,490	-3,015
Administrative Expenses	-159	-513	-218	-432	-404	-463	-552	-674	-805	-1,053	-1,102	-1,429
Other Expenses	-175	-72	-101	-240	-281	-382	-280	-460	-522	-684	-552	-344
Gains or Losses of Long-Term Investments	20	12	-116	-436	150	154	54	183	34	83	-22	79
Other Income and Expense	-102	-267	-126	-430	-156	-870	-570	-204	-365	-376	159	-155
Financial Results												
Total Assets	54	76	4	754	-632	446	594	737	871	1,026	280	2,796
Total Liabilities	-338	-235	-315	-3,636	579	-359	-492	-283	-353	-1,200	1,522	-1,375
Income Tax	-378	-828	-706	-415	-3,293	-3,017	-3,410	-2,801	-2,758	-2,558	-2,408	-3,230
Gain (Loss) for the Year	**477**	**2,057**	**819**	**3,344**	**4,628**	**4,876**	**5,337**	**4,515**	**4,086**	**3,640**	**3,486**	**5,790**

Exhibit 2c Net Profit/Sales History

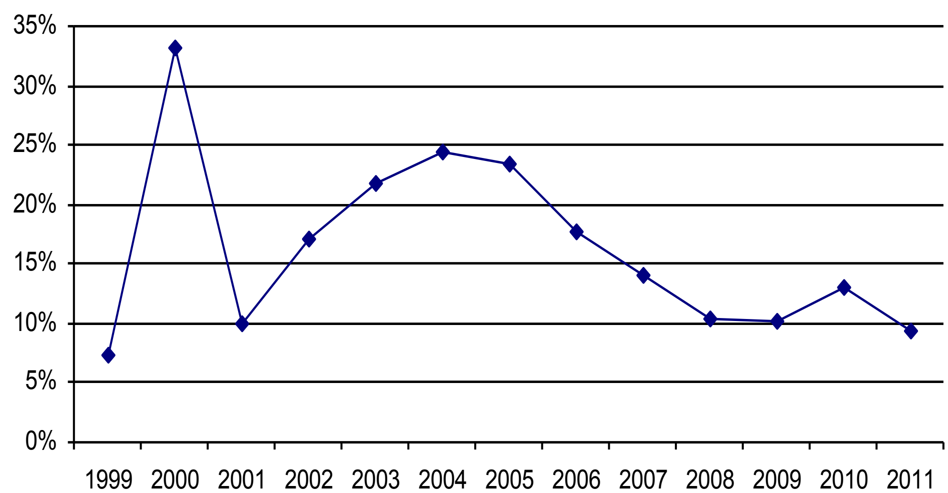


Exhibit 2 (Continued)

Exhibit 2d Sales History (in Millions of Argentine Pesos)

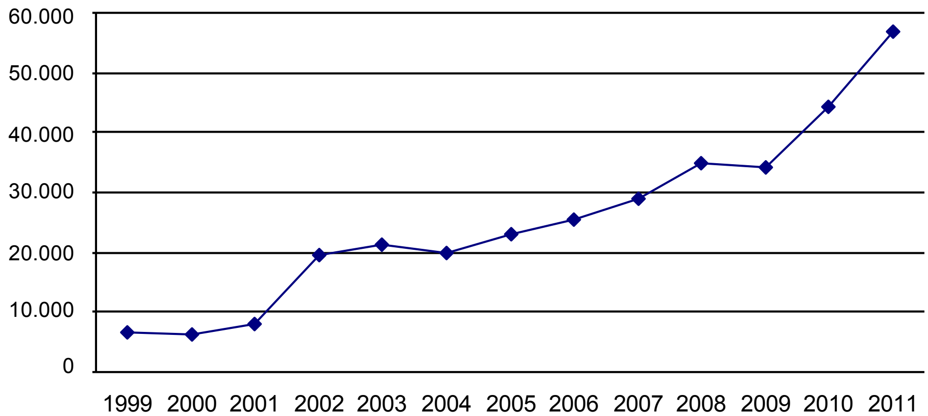


Exhibit 3

Exhibit 3a

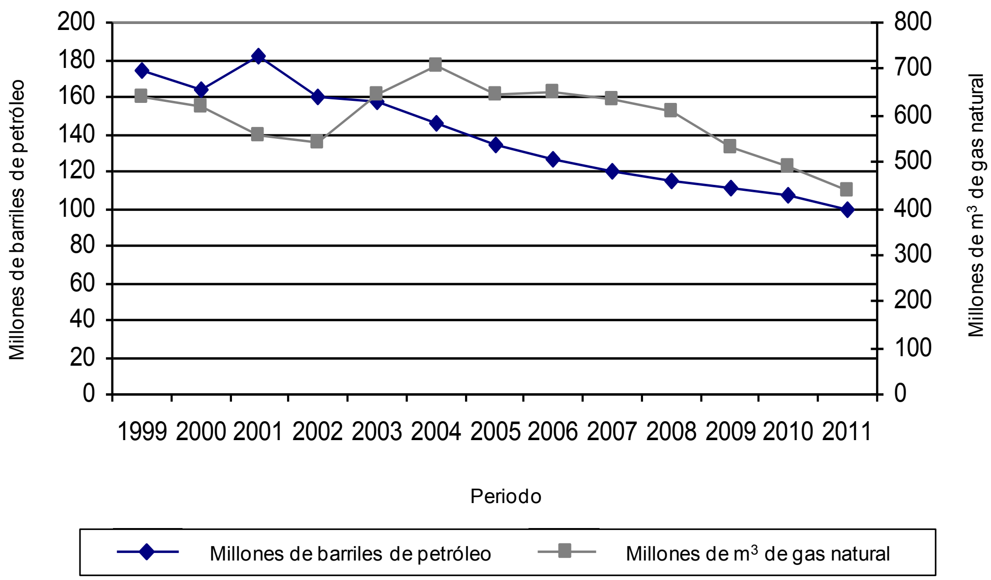


Exhibit 3 (Continued)

Exhibit 3b

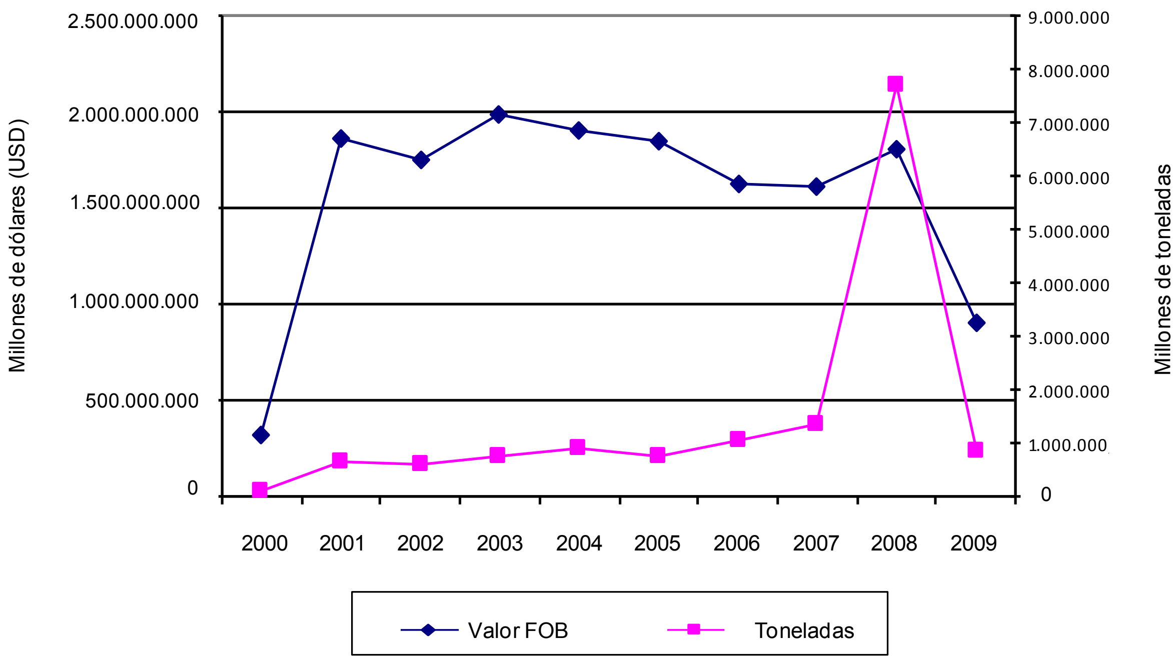


Exhibit 4

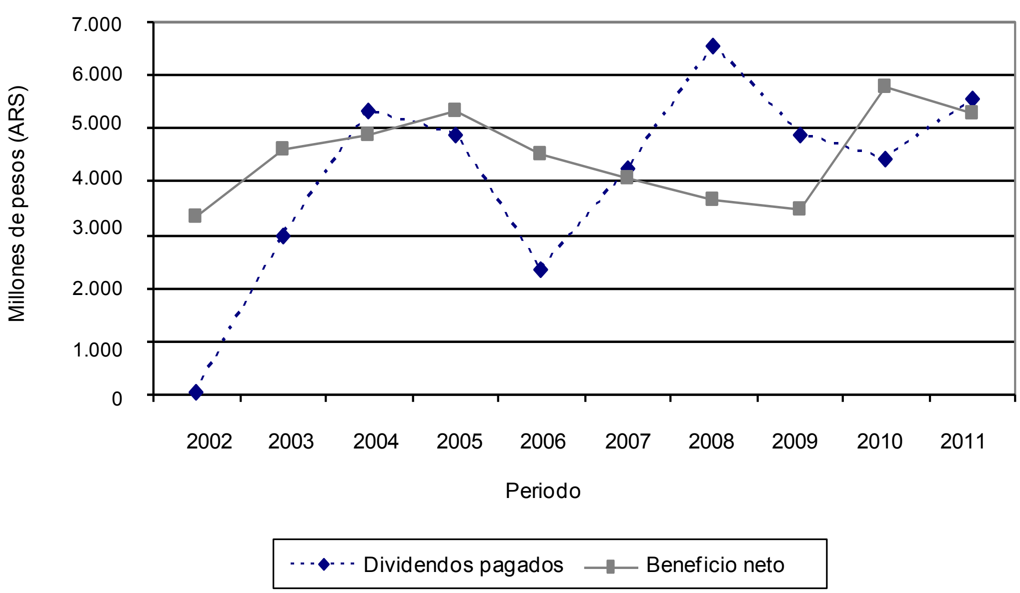


Exhibit 5

Oil Production

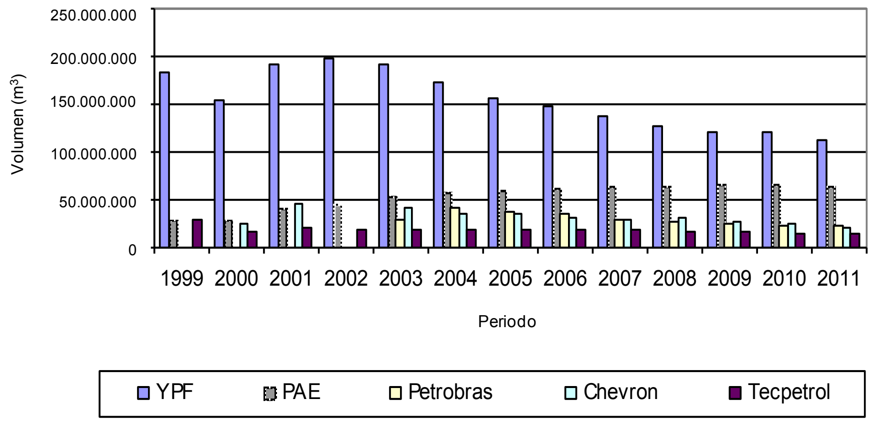
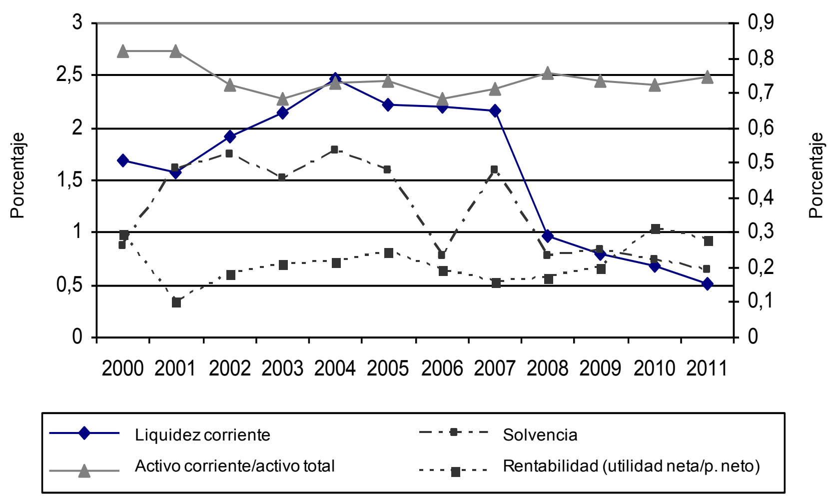


Exhibit 6



Share Price History

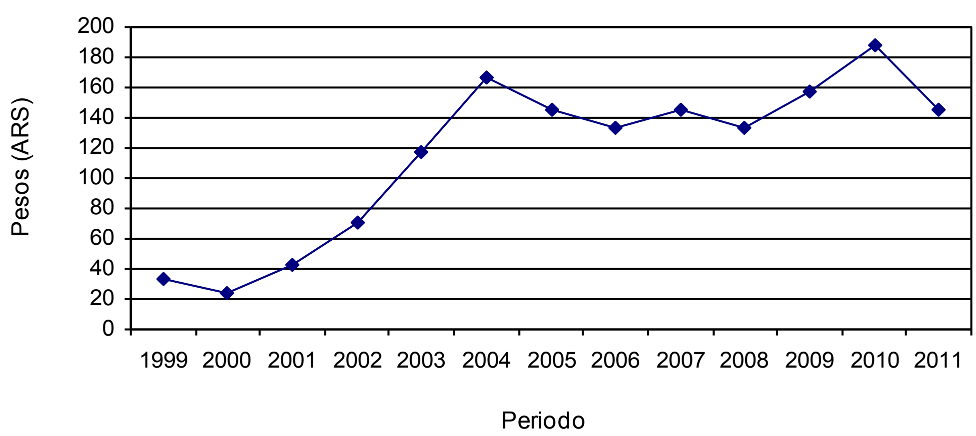


Exhibit 7
Other Spanish Interests in Argentina

Some business leaders of companies with strong interests in Argentina said that "everything possible has been done to reach an agreement in good faith. Now the government has to defend Spanish interests, or these expropriating offensives can reoccur."
It's worth remembering that Spanish companies have significant interests in Argentina—almost 20 are operating in key sectors such as technology, construction, banking and services.
To get an idea of Spanish interests in Argentina, below is a brief list of Spanish companies and their business volume in the country:

1. Gas Natural: Present in the distribution business, its gross operating profit in 2011 in Argentina was €27 million.

2. Endesa: Present in Argentina with 3,264 employees.

3. Elecnor: Worked in Argentina since 1991, and last year began construction of the first phase of the largest solar farm in the Latin American country, in the province of San Juan.

4. Banco Santander: Santander's exposure is small. The net profit obtained in Argentina in 2011 through its subsidiary Santander Río accounted for 5.36% of the Santander Group.

5. BBVA: Owns 75% of Banco Francés; exposure in Argentina is not a very significant risk for this group, since Banco Francés contributes 5.22% of BBVA profits.

6. Telefónica: Its subsidiary in Argentina is the result of the first privatizations in the South American country in 1990. It has a 24,322-strong workforce and achieved revenues of €3.17 billion last year, 3.3% more than the previous year. The operator provides access to more than 23 million users, of which 4.6 million are landline, 16.7 million are cell phone, and 1.7 million are Internet.

   Telefónica has had to negotiate extensively with the government, primarily due to freezing rates and the financial damage suffered with the so-called "pesoization" (the conversion of dollar deposits into pesos), which began in 2002.

   In the last five years, it has invested more than ARS$7.3 billion (approximately €1.26 billion at June 2012 average exchange rates), and has contributed an amount of about ARS$15 million.

7. Indra: Present in Argentina since 1993, it has a workforce of 1,300 professionals.

8. OHL: In 2011 its Argentina subsidiary accounted for 1.1% of the group's total global sales, which totaled €3.43 billion.

Exhibit 7 (Continued)

9. ACS: Operates through local construction company Dycasa, and reached €194.6 million in 2010, 4% of total international sales.

10. NH: Has 13 hotels, and most of them—eight in total—are in Buenos Aires.

11. Meliá: Manages three facilities, totaling 300 rooms.
12. INDITEX: Has 10 Zara stores in Buenos Aires.

CASE C: THE EXPROPRIATION OF REPSOL-YPF (FINAL UPDATE)

YPF: What was next? What is next?

"To require faith in an industry that demands concrete results do not seem the best argument. Galuccio asked faith in a properly executed plan, in the price policy and faith in an agreement with Chevron".

Wall Street analysts and industry experts meeting.

After more than 100 days in office, the new President and CEO of YPF, Miguel Galuccio, presented the new strategic plan of the nationalized oil company during a press conference. He also reported a formal approach with U.S. Chevron to exploit two areas: the unconventional hydrocarbon reservoir of “Vaca Muerta”, which had discovered the Repsol-YPF, and other hydrocarbon reservoir whose name is kept confidential.

Once this plan was presented to the national and foreign press Galuccio said: "expropriation of YPF can harm the search for new investment partners. Further stated that these fears will disappear in the medium and long term as the company continues to send appropriate signals to potential investors: compliance debts (YPF), to continue to trade on the NYSE and the increased production and investment".

The strategic plan provides an ambitious path to invest US$ 37,200 millions until 2017, where 70% is financed by capital, 20% of the debt and the rest, by partners. The plan focuses on increasing production capacity, refining and marketing of YPF. According to analysts at the company, the achievement of these objectives requires an increase in the annual production volume of 20% to 30%. Analysts, support that YPF also must make a real price increase of 15% to 25% above the annual inflation rate in Argentina.

Although YPF CEO expects the funds necessary to finance the ambitious plan, no real agreements have been reached for investment in YPF with international oil companies, even with the oil companies of allied countries, with the exception of Venezuela's PDVSA, but in this case was more a general “cooperation” agreement” than a concrete, pragmatic one.

State management of YPF took the first step on a path of price adjustments for fuel resourcing company. On October of 19th, the director of strategic planning of the company announced a new price increase for the need to adjust prices with other oil companies. So far this year, fuel prices have increased by 8% for premium fuel, 25% of the normal fuels, and 35% for diesel.

Despite the lack of foreign investment, the president of YPF was committed with the investment plan for the next five years, but without specifying to markets how to make it. Since the government has no external funding sources and access to credit markets to finance the operations of the oil company, YPF took financing capital from the local market. The company made a placement of two series of bonds of two to four years. To the debt placement, the Social Security Agency was the main source of funding, for instance, from the $ 1,500 million obtained in the market, the state agency acquired almost 70% ($ 1,000 million) of the total.

Added to the feeling of uncertainty about the funding needs of the company, in a recent analysis by specialists, it was concluded that Argentina will continue depending on imported oil and gas to keep production in the next five years. Moreover, economists argue that the investment requirements of YPF are not available in the local market, and if it were, their use would mean the death of the rest of the private sector.

After the expropriation, the trade deficit worsened in energetic terms. From May to August, fuel imports rose 35% over the same period of 2011. In 2011, the energy deficit amounted to US$ 3,000 millions for 2012; current estimates are even higher, closer to US$ 3,700 million. Also, genuine investment is also expected to be received. So far, YPF signed agreements of intent with several oil companies (Exxon and Brida), but none has committed financial resources.

David Wootton, a prominent figure in the London financial community, said "the expropriation of Repsol YPF was seen with 'disappointment' in the markets that make it difficult to attract capital for the new state company. What happened in YPF was seen as a disincentive to investment because investors need clarity and predictability for business".

In addition to that, the Chinese investment, other possible source of founds for YPF, was no possible. In one Spanish Newspaper a spokesman of them answers, after a question about the investment in YPF: “We are Chinese, not stupid”.

Far from finding a clear horizon for the future of the company, the expropriation of the oil company seems to have deteriorated the financial and operating results of YPF. Therefore, this complex situation raises the question if the expropriation of the company has been a political decision to strengthen the Argentine energy sector, or if it was a measure to sustain the political project of Cristina Fernandez de Kirchner. What is next?

TEACHING NOTE

THE EXPROPRIATION OF REPSOL-YPF

Case Summary

On April 17, 2012, the Argentinian government decided to expropriate the largest company in Argentina. The country's president, Cristina Fernández de Kirchner, invited like-minded governors and business leaders to the Casa Rosada, where she announced that the state was declaring 51% of the shares belonging to Repsol-YPF as the public's property and subject to expropriation. Of that percentage earmarked for expropriation, 51% would go into the hands of the national government and the other 49% would be controlled by the 10 oil-producing provinces. The government will thus have a 26.01% stake, and governors will end up with 24.99%. All shares are expropriated from Repsol and none from the Argentinian Petersen Group, owned by the Eskenazi family, which owns 25.46% of Repsol-YPF. With Repsol—which has been operating in the country for 12 years—the government of Cristina Fernández de Kirchner continued the trend of expropriating foreign companies that began in 2003 with former President Néstor Kirchner.

The dispute over compensation will not have a diplomatic solution, despite the strong cultural and commercial ties that historically bind these two countries. Discussion of the case focuses on a dispute over an expropriation that some label as illegal and others as necessary, but the case's lessons do not center only on the causes that the Argentinian government defends and the strategic and economic damage to Repsol, but also on the dilemmas for the Spanish government and the expectations for Spanish companies already established in Argentina, in a climate of complete uncertainty. The political climate in Argentina has close parallels with other Latin

American countries, particularly Venezuela, Ecuador and Bolivia. Indeed, the general context invites discussion on investment and potential conflicts in countries with high political risk for foreign investors. The dispute between Repsol and the government of Argentina is truly of great interest when it comes to evaluating and forecasting business situations in developing countries that change the rules of the game with each new elected government.

In order to gain in clarity, there is a final revision and update of the situation, where it can be seen that no important agreements have been reached yet and that the price of the oil has increased substantially after the expropriation (which was its main justification). The question is now "what is next?" as a referral to the uncertainty in which this kind of nationalizations usually derive.

However, the underlying problems in these countries have been quite similar for decades, albeit with different nuances. Consequently, the expropriation of Repsol and its context allow us to delve into core issues related to designing strategies for investment decisions in countries with high political risk.

Target Audience

This case study is intended for participants in management programs, with two distinct targets:

- Top-level public administrators with strategic responsibilities in the formulation and implementation of public policies, and with proven experience in public administration.

- Executives with several years' experience performing general management functions or in senior management and participating in strategic business decisions (mainly internationalization decisions).

Methods for Using the Case in the Classroom

The case has two versions:

- The version of events as viewed from Argentina's perspective, highlighting the main reasons why its government opted for expropriation, and its decisions regarding compensation and the company's future.

- The version of events from Spain's perspective, mainly from the company's but also from the government's. It reveals reactions from both parties, decisions and future implications both for the company and for diplomatic relations between Spain and Argentina.

The methodology we propose is to hand out, for individual and group study, the "Argentinian" version of the case to half of the participants, and the "Spanish" version to the other half. The idea is to put half the class in the shoes of the Argentinian government (as the expropriating party, defending their reasons) and the other half in the shoes of the Spanish government and Repsol leaders.

We believe that this methodology can greatly enrich the discussion, since both the solution of the problem and its motives and causes are unclear. This approach will also help exercise participants do something that is very common in both the business world and the government: to defend options that are not exactly their own, but which they must accept because they are based on a party, government or managing committee decision.

Both versions of the case, as can be noted, feature common objective and technical data. But they also contain their "own" section, so to speak, with more biased information, not because of any value judgments, but because they reflect the opposite views of events.

Educational Objectives of the Case

The main objective of this case is to analyze two topics on the basis of the issues raised in the case study:

- On the one hand, the approach for an international investor who decides to enter a country.
- On the other hand, governments' key decisions to attract FDI.

This objective can be broken down into the following sub-objectives:

A. Country Analysis When it Comes to Investing and How to Invest

1. Country risk and evaluation tools. The country risk analysis is performed by means of a multiple perspective that includes the development of international markets, rating agency tracking, and the analysis of the sustainability of economies and of their various components (fiscal, external and institutional liquidity, etc.). The goal is to complete the overall risk position and its implications by developing tools that analyze the risk position in international markets: tracking different vulnerability indicators, developing country risk forecasting models, and complementary studies on the degree of real and financial interconnection among the economies. Exhibit 1 lists the main indicators for analyzing the history of Argentina's country risk.
2. Security mechanisms in investments:
   a. Legal mechanisms.
   b. Diplomatic pressure.
   c. International alliances.

d. Security protocol against possible reprisals.

B. Analysis of Sectors, Especially Extraction Sectors, in Relation to Political Risks

Three variables must be especially taken into account in the sectoral analysis:

- Sectoral growth rate.
- Investment risk in the sector (beta).
- The sector itself. It could be argued, about the extractive sector, that giving concessions to multinationals in this sector and local ruling classes guarantee (or fail to guarantee) stability and steady revenue.

C. Analysis of the Role of Public Affairs in the Strategy of Multinational Enterprises

The goal is to analyze what are the most appropriate mechanisms to establish proper relations with political powers in a given country: lobbies, finding local partners, etc.

D. Analysis of the Role of Governments and the Subsequent Mechanisms for Reaching Agreements

Lesson Plan (Expected Duration: 75 Minutes)

1. Analysis: Particulars of the problem (15 minutes).
2. Discussion about whether Repsol's investment in Argentina was appropriate (15 minutes).
3. Discussion on the causes and context of the expropriation (20 minutes).
   - Defense of Argentina's position (10 minutes).
   - Defense of the Spanish position (10 minutes).

4. Immediate effects on the players involved: Country analysis; safety mechanisms (10 minutes).
5. Alternatives for Repsol and the Spanish government (10 minutes).
6. Conclusions, and delivery of case C after them (5 minutes).

Questions and Class Discussions: Suggestions for the Professor

The professor might begin the discussion with a cold question like, "What responsibility did Repsol have for the expropriation of 51% of its shares?" or "How should the Spanish government react?"

To the question "What responsibility did Repsol have for the expropriation of 51% of its shares?" some students might argue that expropriation is not a surprising move from a government that pursues political interests ahead of elections. Others support the hypothesis that Repsol, as the company assigned to exploit one of the most valuable natural resources in the country, has not fulfilled Argentina's interest but rather addressed only the interests of shareholders and the Spanish government.

To lead in to this, the professor could begin the case discussion with the arguments of the Argentinian government to expropriate 51% of Repsol's shares. First, the government has argued that the company is guilty of fuel external balance deficit. Second, it asserts that the deficit is due to Repsol's lack of investment in new oil exploitation projects. Finally, the company's irrational dividend policy means that profits are reinvested between shareholders so that the money does not stay in the country and, therefore, there is no domestic benefit from production.

To support the proposed discussion, the instructor should analyze data in the Exhibit.

Arguments in Favor of the Expropriation of 51% of Repsol-YPF's Shares

Fuel Trade Balance Deficit

Exhibit 1a of the case (DPO-260) shows the deterioration of Argentina's fuel trade balance, but the discussion about whether it is attributable to Repsol is ambiguous. On the one hand, YPF accounts for 27% of total exports, and that level has remained stable since 2000. The logical, but not crucial, conundrum in the analysis of the case is why the exponential growth of domestic consumption has not led to higher levels of production, investment and exploration. Since it has a representative on the company's Board of Directors, the government knows every detail of the data on production and investment in new fields. This argument tips the balance in favor of those who believe that the expropriation is politically inspired rather than being a response to inappropriate behavior by the company in terms of exploitation and supply. It is therefore important to bring up why this was not detected previously. Undoubtedly, government representatives lack planning capacity. What has been Repsol's responsibility for that deficiency?

At face value, none. But the interests and dynamics of private individuals, at least in this respect, cannot be adjusted if communication does not include joint planning.

Repsol Investment in New Oil Developments

Repsol has invested US$20 billion since 1999. In 2009, its investments totaled US$1.36 billion; in 2010, US$2.16 billion; and in 2011, US$3.26 million – all of those well above the investments made by the second and third operators in the country.

Exhibit 3a of the case shows that, indeed, while Repsol has invested in exploitation, the production of oil and natural gas barrels has dropped – although the level of investment is not proportional to the level of production. But it is true, according to oil experts, that exploration never guarantees the discovery of oil. As a result of investments in exploration, YPF found the Vaca Muerta deposit, estimated to be one of the largest natural gas fields in the world.

The instructor can also open up a tangential discussion about whether the investments have been sufficient or if the level of investment in comparison with other oil companies in Argentina has been adequate.

Dividend Policy

The dividend policy was designed between Repsol management and former President Néstor Kirchner so that the Eskenazi family could gain 25% of the shares and ownership of the company. In the discussion of this policy students should be encouraged to point out the mistake that Repsol made in taking the risk to close a deal with former president Kirchner, although outside the agreements outlined by Argentinian law. Government ministers, including economy and overall planning ministers, have indicated that this policy is not fair, since operating profits are distributed and do not result in any productive benefit to the country from exploiting such a precious natural resource.

Students may be for or against the policy, but it was drafted by the president, exempting Repsol-YPF of any breach.

The evidence in the case indicates that while Repsol may question the effort made in terms of investment, none of the government's arguments are strong enough to determine that the company had anything to do with the energy problems in Argentina. The professor can therefore start a discussion by asking why the government took Repsol's shares. Why not the rest of them, or all of them?

There is nothing wrong with arguing that for the Argentinian government, having a conflict with one player is less problematic that dealing with several at the same time and from different countries. By the same token, by expropriating Repsol's 51%, the government now controls the entire company. A legal reason backs the dispute, and since the dispute over compensation will be resolved by an Argentinian court, there is little hope for Repsol to obtain a compensation it deems just.

For the Country analysis when it comes to investing and how to invest (A) learning objective, it is appropriate to systematically analyze the national and international environment of the country where companies have business interests. We can start with the analysis of country strategies, in which contexts they occur and what results were obtained. The country analysis needs to be done from a historical and dynamic perspective, more so in countries with high macroeconomic risk, such as in Latin America, where the geopolitical context and the interrelationship between presidents and the political and economic objectives they pursue, though similar on the surface, in practice differ greatly.

Country Strategies

A country strategy is reflected in its goals and objectives and the policies to achieve them. The decision to expropriate Repsol must be framed in this context.

Goals and Objectives:

Economic

The government of Néstor Kirchner and Cristina Fernandez de Kirchner has had a constant element: growth through strategies to encourage and enhance the domestic market's development by applying strong subsidy policies for commodities. Fuels have been a substantial part of this strategy. Repsol was a "strategic player" at the beginning of former President Kirchner's mandate, and it has remained so during Cristina's mandate to subsidize the growth of the automotive sector.

This government's clear strategy of increasing currency reserves has made it clear that Repsol could no longer be "useful" for economic and political purposes. The availability of reserves is an indicator of the "wealth" of a country by international organizations and is useful for obtaining credits and avoiding financial crises, bank runs and currency crises that distort the course of proposed strategies and generally destroy any political capital.

In short, the outflow of dollars for dividend payouts plus trade deficit in fuels accelerated the expropriation of Repsol shares, and at any cost.

Policies

The Kirchner couple's policies, similar to those of other developed and developing countries, are focused on the concentration of power. In particular, the Argentinian government's actions are very similar to those implemented by other self-proclaimed "progressive, socialist and populist" countries in the region. The current governments of Argentina, Venezuela, Ecuador and Bolivia and those that generally replicate expropriating measures in the region are clear examples.

The expropriation of Repsol is a populist measure that would meet with no social or political opposition and has had great impact on the electorate. This expropriation therefore fits all the requirements for the increased concentration of power scenario.

It can also be deduced from the evidence in the sequence of events that the Kirchner government is centralized in terms of its decisions. It sends clear signals that the economy and politics are not governed by the market, but administered by the government, a peculiarity of the countries that have jumped on the bandwagon of this new generation of populist and socialists. In this line of thinking, measures serve the spontaneous needs of the economic and political moment.

Another important fact to be considered is the degree of openness of the economy. Therefore, a way of categorizing policies is by whether governments face “outward” or “inward.” There is generally a combined model that on the one hand tends to defend the country's industrialization, restricting imports to some degree and attracting foreign direct investment, and on the other hand calls for a needed openness to import strategic supplies, non-manufactured goods and technologies, for these industries. At the same time, the global effect somewhat forces the government to offset trade, given the interdependence of resources.

Importance of the Context

To properly understand the strategic decision of expropriation, it must be contextualized. Below are the most representative features for the case study:

- National Resources.
- Key players or stakeholders.
- Rules of the game that influence the players’ degree of involvement.

National Resources

Countries’ abilities to achieve their goals hinge on their available resources: human and physical capital and natural and technology resources. The abundance or scarcity of these resources therefore affects the feasibility of policies and incentives.

The contribution of revenues brought by oil and its derivatives is very important, as is the case of food and agriculture commodities. The level of international oil prices and dependence on commodities contribute to the level of reserves that the government needs. Therefore, leaving this natural resource in private hands is unacceptable for the economic policy framework of a centralized government, especially when the economies of developing countries are so commodity-dependent.

Key Players or Stakeholders

We can identify at least six players on the scene:

1. Repsol-YPF.
2. Argentinian government.
3. Spanish government.
4. Countries in the region under similar macroeconomic circumstances, with foreign investors holding contracts in natural resource sectors.
5. Repsol shareholders.
6. YPF owners.

The professor should introduce the following unknowns:

- What will the response be from these stakeholders?
- How threatening is the current Argentinian government for Spanish companies currently operating in Argentina?
- How should they proceed and react?

Repsol

- How will it manage its reputation in other countries in which it operates?

- How can it negotiate new contracts in countries outside Spain after the expropriation?
- What are the projected aftermaths of the expropriation? For starters, the action will be severely punished. The litigation announced by Repsol (at this point, does it have a choice?) looks very distant and has unpredictable consequences, quantitatively speaking, but devastating effects for the company.
- What will be the compensation for expropriation? And, what price are we referring to? The stock price? With what date? The accounting price? The result of discounting future cash flows from new reserves? Who would set the price and when? What will happen from now on to affected shareholders?
- What is the precedent set, or not, for other Spanish companies?

Too many questions, all negative for Repsol, at least in the short term.

Spanish Government

- What kind of a response should the Spanish government give: international arbitration, local courts, economic sanctions, take refuge in international treaties and in the European Community, etc.? Or perhaps the best option is a diplomatic response to avoid damaging ties with a future government, or for the current one not to affect other companies in the country?
- What happens if the Spanish government does not back the company to bitter end?
- How is the Spanish government's reputation affected if it fails to win at least some of the disputes?

Argentinian Government

- Is it interested in negotiating a solution with Spain?
- Will it address potential claims from international organizations?
- How would it politically leverage a possible international economic sanction?
- Is it interested in just the oil? Or in the absence of a strong Spanish position would it apply pressure on other Spanish companies?
- Will it let the next government pick up the political and economic tab?

Countries in the Region

- Would a ruling in favor of Argentina, or no ruling at all, trigger similar measures against Spanish companies in countries in the region? Would this affect only natural resources?

Repsol Stockholders

- How will the eventual fall of YPF shares affect the overall value of the company?

YPF Owners

- What should Repsol do with the remaining YPF shares it owns, even knowing that the dividend payout will not be what it has been until now?
- What is the future of YPF? Will Argentina manage to make the company profitable?

The Rules of the Game

There is no doubt that the Argentinian government is the most important player for the aforementioned reasons. It is a government that focuses decisions and allocates resources according to its needs and strategies.

The international context contributes to its continued centralization. If it coordinates and implements similar policies with every country in the region with similar political outlooks, such as Venezuela, Bolivia and Ecuador, can foreign firms expect to be under greater pressure, or will it occur only with countries with which trade is not all that important?

Theoretical Framework Linked to the Case

- This framework is based on the following theories related to business internationalization:
  - The international economy and globalization: concepts, development and fundamentals.
  - International political trade policy.
  - The multinational corporation: definition, conceptual definition and risk assessment.
  - Business internationalization theories.

Recommended Reading

- **Buisán García, M. and F. Aceña Moreno**: "Estrategias de internacionalización de la pyme española: una visión desde el programa de apoyo a proyectos de inversión (PAPI)," *Ice,* no. 839 (Novemeber-December, 2007).
- **Chambers of Commerce:** *PYME familiar en España 2007-2008* report.
- **Claver Cortés, E., L. Rienda García and D. Quer Ramón**: "El comportamiento de las empresas familiares y no familiares en los mercados extranjeros: un estudio comparativo," *Cuadernos de Gestión,* vol. 6, no. 2 (2006), pp. 11-25.

- **Cruz, C., R. Justo and J. de Castro**: "Family involvement and firm performance: a family embeddedness perspective," working paper*,* IE Business School (2008), pp. 8-9.

- **Denison, D., C. Lief and J. Ward**: "Culture in Family-Owned Enterprises: Recognizing and Leveraging Unique Strengths," *Family Business Review,* 17(1) (2004), pp. 61-70.

- **Fernández, Z. and M. J. Nieto**: "La estrategia de internacionalización de la pequeña empresa familiar," working document no. 02-18(11), Universidad Carlos III de Madrid (December, 2002).

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- **Fuentes Lombardo, G., M. C. Vallejo Martos and R. Fernández Ortiz:** "Aspectos determinantes en la internacionalización de la empresa familiar," *Revista de Estudios Empresariales. Segunda época*, no. 1 (2007), pp. 38-54.

- **Guillén, M. F. and E. García-Canal:** *The New Multinationals. Spanish Firms in a Global Context*, Cambridge University Press, Cambridge, 2010.

- **García-Canal, E., and M. F. Guillén:** Risk and the strategy of foreign location choice in regulated industries, *Strategic Management Journal*, 29(1) (2007), pp. 1097-1115.

- **García-Canal, E., C. Lopez Duarte, J. Rialp Criado et al:** "Accelerating international expansion through global alliances: A typology of cooperative strategies," Journal of World Business, 37(2) (2007), pp. 91-107.

- **Globalization 101:** "History Revisited, Argentina's Nationalization of YPF", published the 24th April 2012 (http://www.globalization101.org/history-revisited-argentinas-nationalization-of-ypf/)

- **Goldstein, A.:** Multinational Companies from Emerging Economies, New York, Palgrave Macmillan, 2007.

- **Guillén, M. F.:** "Business Groups in Emerging Economies: A Resource-Based View," *Academy of Management*, 43(3) (2000), pp. 362-380.

- **Guillén, M. F.:** "Structural Inertia, Imitation, and Foreign Expansion: South Korean Firms and Business Groups in China, 1987-95," *Academy of Management*, 45(3) (2002), pp. 509-525.

- **Guillén, M. F.:** *The Rise of Spanish Multinationals: European Business in the Global Economy*, UK, Cambridge University Press, 2005.

- **Heenan, D. A. and W. J. Keegan:** "The Rise of Third World Multinationals," *Harvard Business Review*, 57 (January-February, 1979), pp. 101–109.

- **Henisz, W. J.:** "The power of the Buckley and Casson thesis: The ability to manage institutional idiosyncrasies," *Journal of International Business Studies*, 34 (2003), pp.173–184.

- **Guisado Tato, M.:** *Estrategias de multinacionalización y políticas de empresa*, Madrid, Ediciones Pirámide (first edition).

- **Leonidou, L. C. and C. S. Katsikeas:** "The Export Development Process: An Integrative Review of Empirical Models," *Journal of International Business Studies* (third quarter, 1996), pp. 517-551.
- **McDougall, P. et al:** "Explaining the formation of international new ventures: the limits of the theories from international business research," *Journal of Business Venturing*, vol. 9 (2005), pp. 469-487.
- **PricewaterhouseCoopers** *Informe sobre la Empresa Familiar en España 2007.*
- **Quintana Navío, J.:** "La internacionalización de la empresa familiar española," *Ice*, November-December, no. 839 (2007), pp. 113-120.
- **Rein, L., E. Claver and D. Ramon Quer:** "Fourth EIASM workshop on international strategy and cross cultural management," Toulouse (September).
- **Root, F. R.:** *Entry Strategies for International Markets*, New York, Lexington Books, 1994.
- **Santiso Guimaras, J.:** "La internacionalización de las empresas españolas: hitos y retos," *Ice*, November-December, no. 839 (2007), pp. 89-102.
- **Seijo Marcos, E. and S. Menéndez Requejo:** "Eficiencia de las empresas familiares en España. Importancia de las estructuras de propiedad y control," working paper, Oviedo University (2005).
- **Welch, L. S. and Luostarinen, R. K.:** "Internationalization: Evolution of a Concept," *Journal of General Management*, vol. 14, n. no. 2 (1988), pp. 34-55.

Supplementary Material: Videos That Can Be Used in Class

- The president of Argentina announces Repsol's expropriation:

  http://www.youtube.com/watch?v=clzywNQ30Rs.

- Reaction from Mariano Rajoy, Spanish prime minister:

  http://www.youtube.com/watch?v=ZUy_Hw8BvX4&feature=related.

- Reaction from Antonio Brufau (Repsol chairman):

  http://www.youtube.com/watch?v=lnLlfg_VGFo.

  http://www.rtvcyl.es/Noticia/BFF89B6E-AC20-FCF4-F90CB27F4A7F6A7B/hallazgo/vaca/muerta/posible/razon/expropiacion/ypf.

- International reactions:

  http://www.youtube.com/watch?v=C1hxlj9vQvE.

Exhibit 1

Argentina's Country Risk History

	2009	2010	2011	2012	2013
Business					
Real GDP (YoY, percentage)	-2.1	8.2	8.9	3.7	3.2
Private consumption (%)	-4.1	7.4	10.8	3.4	2.9
Public consumption (%)	7.2	9.4	10.9	6	5
Gross capital formation (%)	-10.2	21.2	16.6	4.6	3.6
Domestic demand (contribution to growth)	-3.9	10.3	10.9	4.3	3.5
Export (%)	-6.4	14.6	4.3	5	5
Imports (%)	-19	34	17.8	7.2	6.1
External demand (contribution to growth)	1.9	-2.2	-2	-0.5	-0.3
Labor market					
Employment (per annum %)	0.6	1.7	2.2	0.9	0.8
Unemployment rate (% labor force)	8.7	7.7	7.2	7.3	7.5
External sector					
Current account balance (% GDP)	3.6	0.8	0	0.2	0.2
Public sector					
Fiscal balance (% of GDP)	-0.6	0.2	-1.5	-1.6	-1.4
Prices and costs					
Average CPI (%)	6.3	10.5	9.8	10.1	11.7
CPI end of period (%)	7.7	10.9	9.5	11	11.7
Exchange rate (against USD)					
Average	3.73	8.91	4.13	4.55	5.19
End of period	3.81	3.98	4.29	4.82	5.52
Interest rates:					
Average official rate (REPO)	12.4	10.1	13.3	13.6	15.2
Official rate (REPO) end of period	9.8	11.1	18.7	14.5	16.8

Source: BBVA research, May 2012.