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ECUADOR WEEKLY REPORT®

For the week of February 29– March 4, 2016

State Oil's Dirty Secret

On January 13, Ecuador's controversial Constitutional Court (CC) ruled in favor of state oil company Petroecuador in a case regarding pollution near Shushufindi, a town in the oil-producing Amazon northeast. The company alleged its constitutional rights had been breached by decisions all the way up to the National Court of Justice (CNJ), the non-constitutional top court, by ruling in favor of a group of 86 local residents who sued the company over pollution, saying that its crude production had wreaked havoc on their health and livelihoods since the 1980s. The case bears more than a passing resemblance to the two-decades-old Chevron lawsuit that has made global headlines.

The CC decision overturned the 2013 CNJ ruling, which ordered the company to compensate residents of the tropical area following a damage assessment by Quito's Catholic University. The court, infamous locally because of a questionably resolved alleged bribery involving SABMiller unit Cervecería Nacional and for a weak record defending human rights, found that the CNJ judges had violated Petroecuador's constitutional right to due process by applying a "silence procedure" after the company had ignored the plaintiffs'

ECONOMIC INDICATORS

Ecuadorian Global Bonds (Mar 3, 2016)

	BID	ASK
Global 2024	73.75	74.75
Global 2030	62.00	68.00

Source: Bolsa de Valores de Quito

BCE International Reserves In million US\$

Jun, 2015	4,739.19	38.00%
Agu, 2015	4,201.41	-11.00%
Oct, 2015	3,308.36	-21.00%
Dic, 2015	2,495.96	-25.00%
Feb 26, 2016	3,635.22	45.64%

Source: Banco Central del Ecuador

Inflation

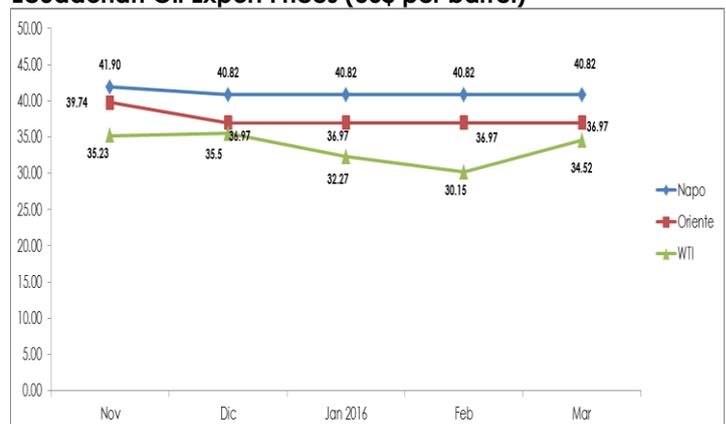
Jan 2016	0.31%
Year to Date	0.31%
Year on Year	3.09%

Banks – Short and long term Deposits In million US\$

Oct, 2015	14,582.60	0.58%
Nov, 2015	14,313.10	-1.85%
Dic, 2015	14,554.40	1.69%
Jan, 2016	14,868.90	2.16%
Feb 19, 2016	14,971.70	0.69%

Source: Banco Central del Ecuador

Ecuadorian Oil Export Prices (US\$ per barrel)



Source: Bolsa de Valores de Quito

demands. It sent the case back to the CNJ, ordering it to retry the case but also to rule in favor of the company.

On its part, Petroecuador, as the company named in the suit, on February 1st spoke of "alleged environmental pollution," adding that "the public oil company is always respectful of what Ecuadorian laws and citizens' rights determine." The case before the CC stemmed solely from its right to due process, leaving the door open for a resumption of the trial before the CNJ. It denied that the CC had shown favoritism in its ruling. The plaintiffs' lead lawyer, Pablo Sarzosa, however said that the only option left is to seek to have the case tried in the Inter-American Human Rights System, which has become a frequent recourse under the present administration of president Rafael Correa, albeit only partially obeyed. Otherwise, victims of decades of pollution would fail to be compensated, he added. According to Sarzosa, the CC also disregarded arguments used by Ecuador's defense against Chevron in international arbitration courts, where the attorney general has said that the company must indeed pay and that the Lago Agrio judgment doesn't contravene the US-Ecuadorian bilateral investment guarantee treaty that went into effect in 1997 (repudiated under the present administration in 2013).

From a humanitarian and environmental standpoint, the situation is dire. Some 9,000 people live in the area of the Pacayacu parish near Shushufindi. On a recent tour to two sites, a group of journalists viewed two large open oil pools, one of which they could only approach by sneaking past the gate of a Petroamazonas facility. The pools did not have any protective

Quito and Guayaquil Stock Exchanges

Equities Most Traded			
Issuing Company	Cash Value (From Feb. 22 to Feb 26, 2016) (In Thousands US\$)	Closing Price (In US\$)	Last Date of Trade
CORPORACIÓNFAVORITA C.A.	288.99	2.05	3/03/2016
INDUSTRIAS ALES	60.92	1.00	26/02/2016
HOLCIM ECUADOR S.A.	16.75	66.70	1/03/2016
FIDEICOMISO OMNI HOSPITAL	14.00	7.000	25/02/2016
SOCIEDAD AGRICOLA E IND. SAN CARLOS	7.91	1.13	26/02/2016
RIO GRANDE FORESTAL S.A.	6.51	2.60	26/02/2016
CERVECERIA NACIONAL CN S.A.	5.68	66.15	2/03/2016
CERRO VERDE FORESTAL BIGFOREST	3.25	32.50	23/02/2016
FIDEICOMISO GM HOTEL	2.97	2.700	26/02/2016
CONCLINA	1.30	1.20	26/02/2016
MUTUALISTA PICHINCHA	0.30	99.99	1/03/2016

Source: Precios máximos y mínimos de acciones & Pulso Bursátil Semanal
Issued by: Bolsa de Valores de Quito.

Fixed Income					
Securities lead by Analytica					
Issuing Company	Issue Type	Total Amount Issued (In Thousand US\$)	Credit Rating	Term (In years)	Yield of Return
OTECEL S.A.	Commercial Paper	50,000	AAA	1	4.25%
ECONOFARM SANA SANA	Securitization	12,500	AAA	5	7.25%
FARCOMED FYBECA	Securitization	12,500	AAA	5	7.50%
EDESA	Commercial Paper	10,000	AAA	1	5.25%
DEXICORP-GRUPO KFC	Commercial Paper	7,500	AA+	1	6.00%
URBANO EXPRESS	Securitization	4,000	AAA-	3	7.50%
		5,000		5	8.00%

coating on the bottom to avoid seepage of poisonous formation water (the water laden with heavy metals and other cancer-inducing molecules) into streams and ground water. The journalists saw one pool largely topped by a coat of caked, burnt oil. Nearby, an open pipe

expelled gas into the air without a flare, dripping formation water onto the forest floor; a bit further on, a flare did burn gas, but only a few meters from the ground, much lower than the legal 15 meter minimum. The second site was adjacent to several Petroamazonas tanks in close proximity to Pacayacu. Around 100 such unprotected pits remain in the area, despite the company's policy of re-injecting formation water down into the depths from which it withdraws the oil.

Local residents told the reporters that they had settled the area several years before CEPE, Petroecuador's original name, began to extract crude in the area in the 1980s. They spoke not only of illnesses and a plunge in agricultural and livestock output, but also of a climate of fear and divisiveness as Petroamazonas threatened to fire anyone who complained. In 2008, the president participated in the inaugural ceremony starting up a drill rig obtained from Venezuelan state oil company PdVSA at the nearby Guanta-19 well. When an elderly woman took him to see a much smaller oil pool a few meters away, he chewed out Petroecuador officials for permitting that kind of pollution. Yet eight years later, little has changed, both in this area and further west, in the area operated originally by Texaco when oil production started in earnest in 1972.

Thanks to the CC ruling in favor of Petroecuador, Sarzosa and environmentalists worry that the case will also affect the prospects of plaintiffs there seeking the \$9bn awarded by a judge in 2011. Chevron, which calls the ruling a legal travesty, still has a similar case to that of Petroecuador pending before the CC, but hasn't commented otherwise. A judge in New York agreed with the company in saying that US and Ecuadorian lawyers had indeed colluded to win

the suit fraudulently. On their part, the plaintiffs are seeking enforcement of the ruling internationally. In the wake of the CC decision, Sarzosa said that it would be impossible for the court to not find in favor of Chevron unless it wanted to establish a precedent favoring state-owned companies over the private sector, which the lawyer called "a double standard when it's about lawsuits against the state." As a result, the CC "has left the country in a very poor predicament in the face of the aims of companies" suing Ecuador in arbitration courts. Beyond the plaintiffs' lawyers in that case, government officials too have constantly demanded that Chevron pay the \$9bn damage award, funding an international campaign to support execution of the case. With around 9,000 victims in this case, a third less than in the Texaco-CEPE area of operations, perhaps a they feared Petroecuador would have to pay around a third in damages, i.e. some \$3bn, at a time when public finances are in particularly dire straits.

Food Fight

The \$41m dispute over real estate formerly owned by the ISSFA, the military's social security and pension fund, has worsened into a crisis between the civilian government and the armed forces. Defense minister Fernando Cordero resigned this week, replaced by Ricardo Patiño, the foreign minister. The administration could have sought to de-escalate the situation between the early replacement of the joint chiefs of staff (EWR787) and their swearing-in ceremony on February 26. Rather than seeking to calm waters, both Cordero and his boss, president Correa, stoked the crisis with

provocative comments that have left many wondering how far the administration aims to escalate the tensions between both sides. Since taking office in January 2007, the defense ministry has had eight ministers, some lasting just a few days.

Correa over the past few days did eliminate one plan that had rankled the military in particular by scrapping a reform that would have sought to have many soldiers occupied elsewhere as firemen, penitentiary guards, transit officers or park rangers. Other changes appeared aimed at stoking dissent between the troops and the top brass. For years, retired officers have bristled at comments he once made during a visit to a military base, when he said he preferred to eat with the troops rather than the "bigwigs", i.e. the officers. According to a retired general, everyone in the military gets the same food, but some separation of mess halls is required given a need for confidentiality in some conversations. Thus, both the complaint by general Luis Garzón, the exiting chief of the joint command, about having just \$3 per day per soldier and Correa's expression of dismay at hearing that in the February 26 ceremony ring somewhat hollow. Users of social networks retorted with the publication of pictures of officers and soldiers sharing meals in the short Cenepa border war with Peru (1995), contrasting them with opulent lunches and dinners at the presidential palace, including with Spanish singer Miguel Bosé on February 12. Not only were both speeches icy; several dozen retired officials walked away, crossing the red carpet, when Correa began to speak (they had also refused to stand up when Correa arrived at the military academy). Correa called them "little naughties,"

ignoring the deep respect active-service officials have for their former commanding officers. The whole scene was bizarre; Correa participated after first having decided not to, entering imperial-style, wearing the presidential sash, but protected by a nervous security detail as if he were fearing an ambush. The new chief, admiral Oswaldo Zambrano, maintained a cautious distance to the government by emphasizing his respect for the constitution, "defense of sovereignty and territorial integrity as well as the protection of the rights, freedoms, and guarantees of the people of Ecuador," he said, to thunderous applause. Correa only won applause from the handful of government officials in attendance.

Cordero didn't give a reason for his resignation, but left after signing two decrees calling for joint recruiting of officers and rank and file as well as "unifying" restroom facilities to reduce inequality between them. Social networks immediately called for the president to share his own restroom in the Carondelet presidential palace with staffers and passersby. Unlike Correa's allies in Venezuela and Bolivia, Ecuador's armed forces have remained reasonably independent of his political project, refusing to succumb to the siren calls of the incumbent. Military spending increased in salaries, but hardware investments have suffered from failures (such as Chinese radars and Israeli drones) and outright scandals (the grounded Dhruv helicopter, against which an air force general had protested and who was murdered). It's unclear that the president's overtures have had any success with the soldiers it has courted. With less than 18 months left in his term, the military appears to have been able to survive the

administration with its independence largely intact. Still, Patiño's arrival will give them reason to worry, considering that he is the most prominent, pro-Cuban leftwing hardliner left in the administration. Tensions regarding the military's autonomy will continue, with the added caveat that Correa said he would continue to pursue changes in the force.

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