ANALYTICA INVESTMENTS

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Today Gone

The demise of center-left Quito newspaper *Hoy* (1982-2014) shines a spotlight on risks to property rights in Ecuador, specifically those who own shares. With the company forcibly liquidated by government-controlled regulators, the owners were left with a bill to pay employees an indemnity. To complete these payments, authorities have moved against *Hoy's* shareholders, putting into question whether Ecuador is willing to protect as basic a principle of capital markets as the limited liability that share ownership entails.

While never commercially as successful as its old, crosstown rival *El Comercio*, *Hoy* had a notable intellectual influence particularly as a center-left publication. It was also a technological trailblazer, introducing fully computerized editing and printing and going online as the first newspaper in Latin America in 1994. From the start, it also played a leading role holding up the banner of a free press: it was assaulted by the leftwing radical group Alfaro Vive Carajo to force it to publish a manifest and, under the government of conservative populist León Febres Cordero, suffered a series of attacks, which refused to advertise in *Hoy* and also leaned on companies not to do so either.

The Correa administration includes some individuals who participated in Alfaro Vive, but also others who worked for Febres Cordero. Perhaps this spelled trouble from the start: As quoted in a chronicle of the papers' fall in *PlanV* by former editor and member of Ecuador's academy of history, Gonzalo

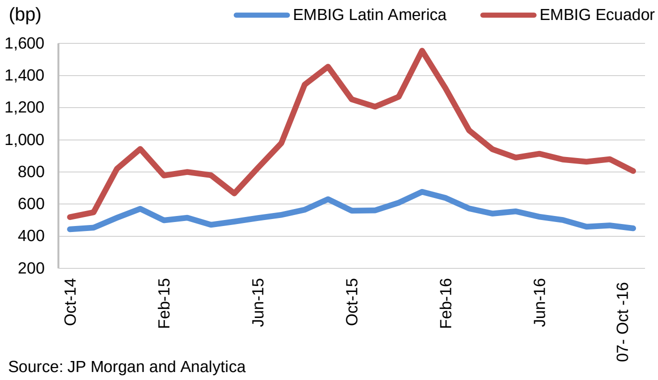
KEY INDICATORS

Ecuador's Global Bond Prices

Bond	Last Price									
	14/10/2016	Sep-16	Aug-16	Jul-16	Jun-16	May-16	Apr-16	Mar-16	Feb-16	Jan-16
Global 2020	103.97	102.51	102.30	100.49	99.38	100.28	95.21	90.54	79.08	74.92
Global 2022	104.38	102.47	102.89	100.03	N/A	N/A	N/A	N/A	N/A	N/A
Global 2024	92.17	90.25	88.05	87.49	87.64	89.44	88.04	82.88	72.81	69.63

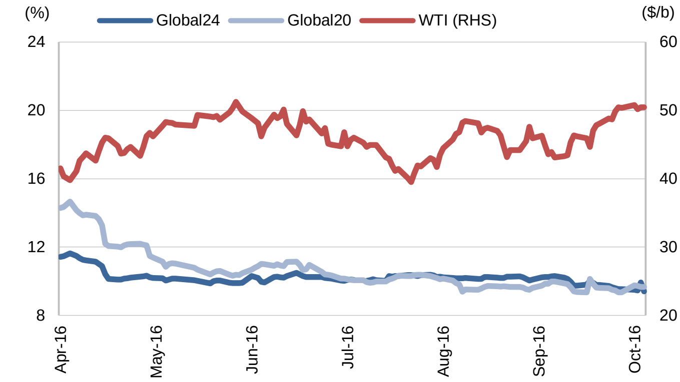
Source: Bloomberg and Analytica

EMBIG Spread



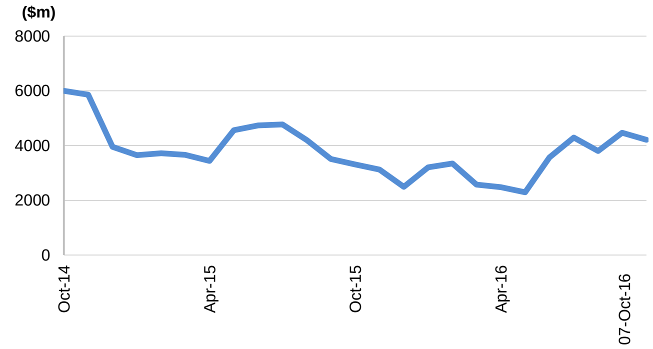
Source: JP Morgan and Analytica

Bond Yields vs. WTI in 2016



Source: Bloomberg and Analytica

International Reserves



Source: BCE and Analytica

Ortiz, in June 2007, on its 25th anniversary, president Rafael Correa asked it to be his government's principal judge. Yet just four months later, he launched an all-out boycott of the paper, barring everyone in the public sector, from the cabinet to staffers at state-owned corporations, from speaking to it. Hoy could no longer be distributed in ministries or aboard state-run airline Tame. Beyond another advertising boycott, Correa also forced it to stop printing English-language schoolbooks for the public education system, a 22-year old business. This even had the temporary impact of forcing English from public school curricula, Ortiz writes.

To hang on, it went online, with a weekend print edition, and amid the hardship, Hoy's owners planned a capital increase. But instead of approving this measure, which would have staved off bankruptcy, the corporate regulator proceeded to order the company's dissolution because its losses had allegedly topped its asset value. This disregarded an audit that had valued its archives alone at $4.6m, but led to the naming an administrator, effectively confiscating Hoy's remains. Small provincial radio stations have suffered a similar fate, largely outside the public eye.

Proceedings at the labor ministry subsequently established the amount of compensation owed Hoy's staffers who lost their jobs at $3.24m, which normally should have been paid from the assets sold off (and the sale of Hoy property did continue in the meantime, which should have lowered the amount owed the workers, begging the question of where that money went). But the ministry ultimately made all 264 shareholders responsible individually and, bizarrely, for the full amount each. To ensure payment, it ordered an asset freeze, which not only included people with miniscule share ownership, it even extended to three government officials and some significant companies. Had this remained in place, it would have kept the companies from being able to pay their own employees' salaries. According to Ortiz, lobbying of labor minister Leonardo Berrezueta, previously Correa's private secretary, by other cabinet ministers narrowly averted a disaster that would have made international news. At its current stage, the ministry has decided shareholders will have to pay up according to their proportional stake in the company. This, unsurprisingly, is still illegal; Ecuadorian law only permits this kind of liability if Hoy's ownership had fraudulently bankrupted the paper. Even the Correa administration would have to revert all of its previous findings to reach this conclusion.

The government's actions against the company and its shareholders may be considered a warning to corporate actors not to cross it. Governments like those of Venezuela or Russia have done the same in past years. But even considering the anymosity that Correa feels for Hoy and its owners make the case unusual, for a country dearly in need of increased foreign investment, the current suffering of Hoy's shareholders offers a textbook case of how to ruin investor confidence.

Slipping Away

Alex Bravo, the former head of state downstream oil company Petroecuador, had been the highest ranking official accused of corruption after the cost of refurbishing the 1976 Esmeraldas refinery ballooned to at least $1.2bn from less than $190m at the start of the administration. Not only did the modernization fail to expand output to more than 110,000 barrels per day, its original capacity; it ended up hitting the government with what president Correa acknowledges is the worst corruption scandal yet after Carlos Pareja Yanuzelli, Bravo's mentor and a former oil minister, became suspicious of having accepted $1m in bribes, among more than a dozen oil ministry officials and Petroecuador.

As part of damage control, administration officials have put the blame on the private sector for tempting an honest man with gobs of cash. Conveniently for him, Pareja left the country late September, a few days before the administration went public with the accusations. Oddly, it was the presidential legal counsel, Alexis Mera, along with vice president Jorge Glas, who revealed the bad news, rather than prosecutor general Galo Chiriboga. Controlling the spin took precedence over independence of the judiciary from the executive branch.

After the resignation and flight to Miami of central bank president Pedro Delgado, a second cousin of the president, in December 2012, Pareja is the second top official close to Correa having been able to leave the country before being arrested. Mera denied that the government is protecting Pareja. Chiriboga rejected criticism for allowing him to leave the country, saying that the evidence implicating Pareja had only been received from official sources in Panama after the former oil official had already left. But investigative news portal Focus Ecuador had already identified and published information raising allegations against him, particularly since he had an offshore company in Panama called “CAPAYA,” as in Carlos Pareja Yanuzzelli.

Bravo is now being described as the “paymaster” for the reception of bribes by contractors and distribution to officials via various companies registered in Panama, thanks to the information leaked via the “Panama Papers” scandal. Embarrassingly, the president himself in May vouched for Pareja’s honesty. While most recently blaming the evils of money and power for having seduced an honest man like Pareja, the case leaves both him and Glas tarnished. After all, Pareja was one of Correa’s closest advisors in the oil business. In 2006, both had demanded the confiscation of Occidental Petroleum’s assets in Ecuador for breach of contract. Correa’s predecessor, Alfredo Palacio, stripped the company of its property here, provoking the arbitration suit that forced Correa as president to pay the company close to $1bn in compensation.

On his part, Glas said that the case proves the administration will not hesitate to distance itself from one of its own in the event that corruption is discovered. The size of the bribe in itself appears relatively modest considering the giant budget of the refinery; the number of people and companies involved however as well as the budget’s inflation over the years, coupled with reports of continued operational problems at the Esmeraldas refinery, have led many to suspect that this is only the tip of the iceberg.

With diminished credibility, the corruption scandal will cost the government points with undecided voters as the election campaign gets underway. De jure, campaigning is restricted to the brief six weeks before the February 19 vote; de facto, it started when former vice president Lenín Moreno, whom Glas is accompanying on the ticket, returned to Ecuador from his position paid by the government of Ecuador at the United Nations in Geneva late September. His nomination as the candidate for Correa’s political movement, Alianza Pais (sic), already drew fire as government-controlled television networks broadcast the event in full, leading to accusations of favoritism and impropriety.

Operationally, Petroecuador can’t be expected to get its act together before Correa’s successor takes office next May 24. Despite the turmoil at its helm, with business as usual, the company can expect to at least continue generating revenue given the recent relative improvement in oil prices. Politically, the weight of corruption scandals amid the poor economy will however pose problems for AP as voters ask themselves where all the money from the oil boom went.