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Best regards,
Judy Kuan
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Will the Enactment of New Energy Regulations Facilitate the Financing of Energy Projects in Mexico?

BY GONZALO VARGAS AND JAVIER LABRADOR
(GONZÁLEZ CALVILLO, S.C. - MEXICO CITY)

The last decade has seen a wave of liberalization and privatization of infrastructure development and, in particular, energy activities in Latin America. The availability of long-term foreign financing and the reforms undertaken by governments have allowed the participation of private investment in the energy sector. This participation has been driven by the need to increase investments toward expanding capacity in an environment where governments are limited by tight public budgets.

Whatever the outcome of Mexico's energy reform, we believe that it will (i) open new investment opportunities; (ii) create a legal framework that grants legal certainty to investors; (iii) guarantee the quality, efficiency and safety of the supply of electric energy; and (iv) supply the Mexican industry with energy

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Brazilian Cross-Border Project Finance and Foreign Exchange Controls

BY ISABELA COSTA DE FARIA AND ANDREW B. DERMAN
(TAUIL & CHEQUER - RIO DE JANEIRO, BRAZIL,
IN ASSOCIATION WITH THOMPSON & KNIGHT LLP)

Introduction

Developers of large-scale Brazilian energy infrastructure projects are increasingly relying on project financing to raise funds. Project financing has been used in connection with the appraisal and development of oil fields, including offshore platforms, the construction of pipelines and transportation systems, and the building of electricity power plants.

Many of these projects have involved cross-border transactions with international financiers and well as foreign shareholders, contractors and lessors. Project financing in Brazil must adapt to the requirements of Brazilian law and practice. The article will discuss several of the banking and legal issues surrounding cross-border project financing in Brazil today.

Foreign Currency Account for Energy Projects

It is permissible to establish a foreign currency account in Brazil for oil, gas and energy projects. Brazilian Central Bank Resolution 2644, dated September

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April 29, 2004

Highlights

MEXICO: Despite increased foreign financing availability, investors must watch out for traditional project risks.

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BRAZIL: Foreign exchange controls and strategies for hedging against cross-border project risk.

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PANAMA: New petroleum policy seen to bring new investment opportunities for local and foreign companies.

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BOLIVIA: Uncertainty reigns as natural gas regulations remain in limbo.

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VENEZUELA: Doubts on PdVSA's oil output capacity; Venezuela and Trinidad trade data on gas reserves; pending oil supply deal with Guyana; investments in PdVSA refineries; Hovensa refinery sells bonds.

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OIL & GAS: Petroecuador to boost oil production; Indonesia LNG deal in Mexico; Indonesia offers gas supplies to Chile; Chile contemplates investment in Argentine gas fields; possible Brazilian-Venezuelan joint venture for Argentine oil exploration.

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BRAZIL: New round of energy integration talks; first public bid scheduled for PROINFA alternative energy program; delay in new power sector regulation; new Eletrobras CEO announced.

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Brazil Project Finance

Brazil Cross-Border Project Finance from page 1

10, 1999, provides that a Brazilian company that assumes responsibility for the organization and development of an oil and gas project or a power project may open and operate a foreign currency account in Brazil (known as a “2644 Account”). Foreign currency can be deposited into an account in an amount equivalent to the Brazilian currency (*Reais*) generated by the activities related to either oil and gas operations (prospecting, exploration, production, processing and transportation activities) or electrical power projects (generation and transmission).

The primary advantage of a 2644 Account is that foreign exchange variation risk can be managed or mitigated.

To open a 2644 Account, the Central Bank requires that the interested company present an authorization or concession granted by the National Petroleum Agency (*Agência Nacional de Petróleo*—ANP) in the context of oil and gas, or by the National Agency for Electrical Power (*Agência Nacional de Energia Elétrica*—ANEEL) in the context of power generation. Only certain authorized banks are permitted to manage 2644 Accounts and engage in currency exchanges in Brazil. Should either the ANP or ANEEL cancel such authorization or concession, the Brazilian company shall close its 2644 Account. Any balance existing when such a 2644 Account is closed will be converted into *Reais*.

Funds deposited in a 2644 Account may be freely invested outside of Brazil in foreign markets, as determined by the account holder. Consequently, the 2644 Account is often used as a “hedge” to provide protection for the funds deposited in connection with the project to be financed. The receivables generated by the project are frequently denominated in *Real* and the debt (financing) are typically paid, in whole or in part, in foreign currency. The primary advantage of a 2644 Account is that foreign exchange variation risk can be managed or mitigated. Funds deposited into 2466 Accounts are only to be drawn to pay foreign remittance with respect to the project payment obligations.¹

Other Brazilian Foreign Exchange Regulations

All foreign loan transactions, cross-border lease/charter agreements (with a term greater than 360 days)

as well as foreign direct investments must be registered before the Central Bank of Brazil, in accordance with its on-line information system, known as SISBACEN (*Sistema de Informações Banco Central*).

Financial Operation Registration (“ROF”)

The Central Bank approves foreign loans by issuing an electronic document called a Financial Operation Registration (*Registro de Operação Financeira*—ROF), pursuant to Ordinance 3027, dated February 22, 2001. The ROF delineates the names of the parties to the transaction, the basic financial conditions and the payment terms for the principal, interest and charges. Prior to the deposit of foreign currency funds, the Brazilian borrower (or its legal representative) must apply for and receive a registration number. This number shall be included in the currency exchange contract associated to the disbursement. Prior to the remittance abroad of any principal and interest, the borrower shall obtain an electronic schedule of payments with the Central Bank, in connection with the ROF.

The Central Bank usually grants automatic on-line approval for the ROF, except in those situations where it has been determined that the cost of the transaction exceeds the international market price, or where the structure of the transaction falls outside of on-line system requirements. On occasion, where the transaction is particularly sophisticated and complex, it may be necessary for borrowers to present the financial aspect of the project to the Central Bank before obtaining ROF approval. Recently, the Central Bank delayed a complex financing transaction with two Brazilian special purpose companies as borrowers, and jointly and severally liable to the lenders for all outstanding debt. The Central Bank, in this situation, issued three ROFs for each Brazilian special purpose company, one for each loan and linked all of the debt through SISBACEN.

To avoid delays with the Central Bank, borrowers should be prepared to explain their transaction to the Central Bank and to pay close attention to the loan disbursement schedule.

The ROF is valid for 60 days from its registration date. If no funds are deposited into the Brazilian account, the ROF will automatically be cancelled. The validity of ROF registrations is limited to 120 days from the respective due date, in connection with the closing of exchange contracts and the offshore transfer of *Reais*.

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Petroleum Free Zones of Panama

BY JUAN FRANCISCO PARDINI
(PARDINI & ASSOCIATES - PANAMA)

When the original Petroleum Free Zones legislation was passed back in 1992, Panama was poised to become a major oil and downstream products redistribution center for two main reasons. One was the existence of the Panama Canal creating a natural storage market as well as a transshipment point. The other reason was pricing. During the last 10 years, Panama also privatized its container ports, which were upgraded to state-of-the-art facilities. New modern container ports were built, and Panama became the number one country in Latin America for container movement in 2002.

The global oil industry has changed dramatically in the past 10 years. In order to restructure its oil industry, Panama recently adopted new legislation.

Cabinet Decree No. 36 of September 17th, 2003, was enacted to make changes to the industry, develop ground rules for a national petroleum policy and spur the development of petroleum free zones.

Concept

The free zone concept is inherent to Panama's historical condition as an international commercial, maritime and trade center due to its strategic geographical position. All transactions are tax free within the free zone. As a consequence, Panama developed the Colon Free Trade Zone, the second biggest in the world after Hong Kong, and now is pursuing the Petroleum Free Zones.

Legal Aspects

Cabinet Decree 36 of September 17, 2003 (Decree), superseded, even as it embraced many provisions of the prior legislation, creating a legal framework to establish a petroleum policy and to open the market for petroleum derivatives in Panama. The new policy and the market opening are expected to bring new investment opportunities for both local and foreign companies that can take advantage of Panama's strategic geographical position, installed storage capacity for petroleum by-products, and human resources.

Scope of Operations

Within any Petroleum Free Zone, individuals or corporations, national or foreign, may perform multiple operations under a special tax regime, as follows:

- a. introduce, store, refine, transform, manufacture, mix, purify, bottle, market, transport, transfer, pump, sell for the domestic market, export, re-export, and, in general, manage and supply crude oil, semi processed or any of its by-products;
- b. petroleum Free Zone Users Type B are only permitted to introduce, store, dry, mix, export and reexport crude petroleum, semi processed or any of its by-products in or from a Petroleum Free Zone;

The new policy and market opening are expected to bring new investment opportunities for both local and foreign companies.

- c. build, install and operate petroleum refineries and other transformation or processing means of crude oil or semi-processed, storage tanks, oil pipelines, gas pipelines and poly-pipelines, pumping installations and pipes, buildings for offices, warehouses, or workshops and any other installations; introduce machinery, equipment, spare parts, containers, bottles, vehicles, furniture, equipment for fire or spill prevention; construct buildings for offices, warehouses, workshops for the use of the beneficiaries of the contracts to operate in the Petroleum Free Zones in any of the activities mentioned in a) above;
- d. lease, acquire or in any other manner use lands, easements, right of way and other real or personal rights in regard to *bona mobilia* located in the areas designated as Petroleum Free Zones;
- e. establish water services, electrical power, gas, energy, heat, refrigeration or any other kind of services, upon previous coordination and approval with the respective public entities;
- f. build ports, piers, dry docks, shipping and unloading places for ships and airplanes,

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Panama Free Zones from page 3

railroad stations for loading and unloading on land or granting contracts for the construction and exploitation of such works; and

- g. engage, in general, in all kinds of operations or activities proper or incidental to the establishment and operation of the Petroleum Free Zones for the introduction, storage, pumping, transference, distribution, marketing and/or crude refining and petroleum by products.

In accordance with the Tax Code, crude oil and petroleum by-products will enter Petroleum Free Zones exempt from taxes, fees, levies and other duties.

Market Destination

Furthermore, crude oil and products derived from petroleum which are introduced into the areas of the Petroleum Free Zones, may be released from the zones tax free for the following purposes:

- a. for exportation and re-exportation;
- b. for sale or delivery to the contractor or other users that operate legally in the Petroleum Free Zone or in another Petroleum Free Zone;
- c. for importation to be used or consumed within the customs territory of the Republic of Panama;
- d. to be sold to ships that pass through the Panama Canal with destination to foreign ports or that ship between any qualified port of the Republic and foreign ports;
- e. to be sold to airplanes that use Panamanian airports, as long as the quality requirements are met, according to the international standards of the Joint Operation System;
- f. to be sold to official entities of foreign governments or international entities that may import into Panama's customs territory goods which are exempt from import tax;
- g. to be sold to electricity companies (when authorized by the Regulating Entity for Public Utilities).

Investment and Operations Requirements

Companies interested in investing or operating within a Petroleum Free Zone to perform any of the activities detailed in the "Scope of Operations" section above must qualify and fulfill the requirements for one or more of the different categories available, as follows:

- Petroleum Free Zone Contractor (*Contratista de Zona Libre de Petróleo*)
- Petroleum Free Zone User Type A Permit
- Petroleum Free Zone User Type B Permit
- Permit to Provide Products derived from Petroleum by means of Barges
- Permit as Importer-Distributor of petroleum derived products for sale in the domestic market
- Permit as Importer-Distributor of petroleum derived products for electric generation
- Permit as Sub-Distributor of petroleum derived products in wholesale distribution in the domestic market
- Permit as Importer-Distributor of Liquid Petroleum Gas (L.P.G.) for the Domestic Market
- Permit to Recycle or Permit for Lubricant Plants (Oils and/or Greases)
- Permit for Importers of Lubricants (Oils and/or Greases)
- Permits for Analysis Laboratory
- Permit for Independent Inspector
- Contractor to Refine Hydrocarbons

The contractor of a Petroleum Free Zone is responsible with operators in the Petroleum Free Zones for losses and damages done to the state. In the event of any accident and/or contamination within the Petroleum Free Zone caused by the activities of the contractor, the companies established in the Petroleum Free Zone and their suppliers, the contractor must make the corresponding works of decontamination, clean-up and repair, without prejudice of any other responsibility of the contractor, of the companies established in the Petroleum Free Zones and their suppliers that may come with third parties or the competent authorities, without prejudice of the right of the contractor to repeat against the originator of the accident and/or contamination.

Tax Considerations

In accordance with the Tax Code, crude oil and petroleum by-products will enter Petroleum Free

Zones exempt from taxes, fees, levies and other duties. These products may be transferred exempt from taxes, fees and levies provided that the purpose of the sale falls under subsections a), b), d), e), f) and g) of "Market Destination" above.

All income arising from transactions within PFZs or others specifically determined by law shall be exempted from income tax.

Conclusion

Panama has turned into an important oil and downstream products redistribution center because the Panama Canal has created a natural storage market as

well as a transshipment point, and for pricing reasons. However, there is much room for improvement and growth.

The projected \$5 billion expansion of the Panama Canal to allow the passage of larger oil tankers will add a new dimension to the Petroleum Free Zones.

Ten years after the original legislation that stimulated the petroleum service industry in Panama, the new legislation is expected to create new investment opportunities and encourage new companies to enter the market.

Juan Francisco Pardini is a Partner with the Panama law firm of Pardini & Associates.

Bolivia Hydrocarbons Update: Does No News Mean Good News?

BY RICARDO INDACOCHEA
(INDACOCHEA Y ASOCIADOS – SANTA CRUZ, BOLIVIA)

Paralysis in the Natural Gas Sector

"No news is good news" is a phrase that is often used, but it evidently does not apply to Bolivia these days. The subject of hydrocarbons in Bolivia has historically been a very controversial and political one. An example of this "no news" phenomenon can be seen in the past couple of years, where the Bolivian people have been demanding the amendment of the Hydrocarbons Law. Their primary objective is to increase benefits to the Bolivian Government through the creation of new taxes for oil companies. So far, the increasingly popular demand has resulted in the forced resignation of former President Gonzalo Sanchez de Lozada in October of 2003. His successor, President Carlos Mesa promised that within two months of his appointment, the Hydrocarbons Law would be amended, taking into consideration these demands. Among many other things, the demands included the following:

- the increase of taxes to hydrocarbons producers,
- that hydrocarbons be declared as State property,
- that state-run oil and gas company, *Yacimientos Petrolíferos Fiscales Bolivianos* (YPFB), not export the gas through Chile due to historical reasons for which a Referendum is required, and
- that YPFB be given a more prominent role in future contracts with multinational companies as an operating partner in new ventures, and

not as a mere supervisor of exploration and exploitation hydrocarbons contracts.

President Mesa clearly understands the population's demands. Yet, his government's inability to reach an agreement between political parties and the private oil and gas investors has resulted in a significant obstacle to the efforts of drafting a consensual amendment. So far, the challenge of amending the Hydrocarbons Law has been entrusted to more than one Minister of Economics and four Hydrocarbons Ministers (Mr Illanes and Mr. Berindoague from the Sanchez de Lozada ministry cabinet, Mr. Alvaro Rios who resigned due to political pressure, and Mr. Antonio Aranibar, a former Chancellor who lasted only 30 days before resigning). None were able to present a palatable final version of the Hydrocarbons Law.

Under political pressure, President Carlos Mesa decided to submit to Congress a draft of the Hydrocarbons Law. This draft calls for the establishment of a progressive complementary hydrocarbons tax (ICH) of up to 50% on the production of new hydrocarbons, in addition to those demands mentioned above. If the draft law is approved in its submitted form, the implications will be that new contracts will be subject to the ICH, which would replace existing taxes on sales and profits, and the total tax obligation of the companies would be raised to a level of 50%.

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Bolivia Hydrocarbons

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Needless to say, these legislative proposals have generated unease among international investors, who have invested over US\$3.5 billion into Bolivia since the beginning of the Capitalization Process. The general uncertainty regarding the amendments to the Hydrocarbons Law and the lack of political power of the Mesa government has resulted in the paralysis of all future investments by the private oil companies in Bolivia. This will most likely remain the case until these companies know for sure what the new rules of the game will be. The current situation arises from the fact that the companies are not sure what the final outcome of the amendment will be, after Congress has reviewed it. Therefore, these companies have forewarned that they will initiate arbitration procedures against the Bolivian Government in the event that the new Hydrocarbons Law becomes detrimental to their existing rights. As the draft looks, assuming no changes are made and if investors abide by their statements, it is certain that arbitration will be an available option. This is also not good news for Bolivia.

Natural Gas Referendum

Facing heavy pressure from the Bolivian population, Mr. Mesa has also agreed to modify the Bolivian Political Constitution, through the use of a referendum to allow for popular participation. Given the inaction

of Congress in passing a law that would call for a referendum, President Mesa has issued a Supreme Decree by which he set July 18, 2004 as the date for the said referendum. The issues to be voted on will be made public 60 days prior to the referendum, on May 19, 2004. The processing of information will be the responsibility of the National Electoral Court. The main goal of this consultation is to satisfy the popular demand to participate in the decisions regarding the country's natural gas reserves.

If Bolivians respond on the referendum that gas should not be exported, Bolivia would lose the Pacific LNG project, a project estimated at US\$5 billion, consisting in the export of liquefied natural gas (LNG) to Mexico and the United States through a pipeline to the Chilean or Peruvian coastline. This project is still in the negotiations phase.

All decisions and negotiations for any future projects concerning the gas reservoirs, such as the construction of a petrochemical plant along the Brazilian border, are currently on standby.

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Venezuela's PdVSA Won't Boost Oil Output Capacity, Drillers Say

BY PETER MILLARD

CARACAS (Dow Jones)—Venezuelan state oil company *Petroleos de Venezuela S.A.* (PVZ.YY) announced an ambitious \$5 billion investment plan at the start of this year to boost production capacity, but drillers on the ground have seen no signs of a rebound.

After a quick but incomplete recovery from a crippling strike last year, PdVSA continues to produce well below its OPEC quota, independent analysts say, and will have to carry out large investments to prevent oil production from declining, especially at mature fields. Venezuela's troubles, combined with production difficulties in Iraq, have helped keep world oil markets tight and prices high.

PdVSA says it will increase the number of operating rigs to 102 by the end of this year, up from around 80 at present, but this requires help from international oil service companies to drill new wells and perform workovers on mature wells. So far, the promised increase isn't in evidence, said an executive with one driller operating in the country.

"We have less activity than last year," the executive said. "There is no certainty that PdVSA will reactivate" drilling operations.

The executive said the company is operating six rigs in the country, down from 10 as recently as last August. The company plans to raise its active-rig count to eight after bringing two rigs on line in Western Venezuela's Lagunillas oil fields next month.

PdVSA is still recovering from a two-month white-collar strike that ended in February 2003. With shippers on strike and around half the company's staff absent from work, the company was forced to halt exports and shut in oil production. The government says the strike cost the nation around \$10 billion in damages and lost revenue, but claims to have fully restored output.

"After the strike, PdVSA was able to recover somewhat, but never the 3 million barrels a day that the president of PdVSA says," said an executive at another firm that performs workovers on mature wells.

Independent analysts say PdVSA has stabilized production at 2.5 million to 2.7 million barrels a day, compared with a quota of 2.7 million barrels a day. Venezuela was the fourth-largest supplier of crude oil to the U.S. in January, according to the U.S. Department of Energy, accounting for 14% of U.S. imports.

Not only is PdVSA having trouble increasing its output, it has also been tardy in paying contracted companies.

Schlumberger Ltd. (SLB) Chief Executive Andrew Gould recently said tardy payments from PdVSA contributed to decline in Venezuela revenue in the first quarter of 2004. Schlumberger is one of the largest oil service companies operating in Venezuela.

"We're not getting paid at the same rate as in previous regimes," Gould said during a conference call last week.

He doubted Venezuela would be able to increase drilling activity in the near term due to political uncertainty and contractual issues.

The one area drillers noticed increased activity is Monagas State, where oil and natural gas is produced. PdVSA has added six new rigs since the start of the year in the state, but most of the new rigs will be drilling for natural gas, one oil service company executive said.

"We will at least maintain current levels of production capacity," the executive said, referring to oil production in Monagas.

Drillers see activity remaining flat, but PdVSA is promising more contracts later this year. One driller said PdVSA has offered a licensing round for new rigs in the Maracaibo oil fields in September, but he is doubtful it will materialize.

"They've been holding meetings and letting us in on future plans, but we have to see that come," the president of a small drilling firm in the Maracaibo area said.

Activity has "not gone up or down" so far this year, the person said.

Venezuela, Trinidad Trade Data on Gas in Border Areas

BY PETER MILLARD

SCARBOROUGH, Tobago (Dow Jones)—Venezuela and Trinidad signed an agreement on April 21 to exchange data on natural gas reserves in the Deltana platform that stretches across both countries' maritime borders, said Trinidadian Oil Minister Eric Williams.

Venezuela has sold three exploration blocks off the Eastern coast of the country, and some of the natural gas fields may connect with fields currently being developed by Trinidad.

"What we signed today was the rules of engagement for exchanging data," said Williams, speaking to reporters at an oil conference in Trinidad Wednesday.

Williams said he expects the countries to reach a definitive agreement on how much of the natural gas fields belong to each country by the end of this year.

The deal is of crucial importance to Venezuela and the planned development of the Delta Platform, which contains an estimated 38 trillion cubic feet of gas. Venezuela has sold three exploration blocks in the gas-rich continental shelf extension of the Orinoco River's delta.

ChevronTexaco (CVX) has bought the rights to explore and develop two blocks in the area and *Statoil ASA* (STO) has bought one block.

Venezuela Oil Min: PDVSA to Invest in Refineries in 04

BY ADRIANA BRASILEIRO

RIO DE JANEIRO (Dow Jones)—Venezuela plans to invest in its domestic refinery network this year to lower the sulfur levels in gasoline it produces, Oil Minister Rafael Ramirez said Monday.

He said state oil company *Petroleos de Venezuela SA* (PVZ.YY) will use a portion of its \$5 billion 2004 investment budget to upgrade refineries.

"We will decide in the near future how much of that investment will be used in refining," to lower the sulfur percentage, said Ramirez, speaking to reporters on the sidelines of an electricity and gas forum.

Venezuela is a major exporter of gasoline to the U.S., and PdVSA officials say the company is taking steps to meet stricter gasoline requirements in the U.S. during the summer driving season.

Guyana PM Says Hopes to Sign Oil Deal with Venezuela Soon

BY PETER MILLARD

SCARBOROUGH, Tobago (Dow Jones)—Guyana expects to sign a deal with Venezuela in the coming months to purchase 10,000 barrel a day of oil at favorable prices, Prime Minister Samuel Hinds said last Tuesday.

Speaking to reporters on the sidelines of an energy conference in Tobago, Hinds said Guyana hopes to sign the agreement in "another month or so."

Venezuela already sells cheap oil to a dozen countries in Central America and the Caribbean under a so-called Caracas accord that was implemented in 2000. The oil sales to Guyana would fall under the same accord, said Hinds.

Relations between Venezuelan and Guyana improved earlier this year, when Venezuelan President Hugo Chavez said he would no longer object to oil exploration by Guyana in the disputed Essequibo territory. Venezuela has refused to accept an 1899 treaty that gave the Essequibo to then-British Guyana. The Essequibo is rich in oil and minerals.

Hovensa Refinery Sells \$51M in 2022 Bonds

BY PETER MILLARD

CARACAS (Dow Jones)—The Hovensa refinery in the U.S. Virgin Islands sold a \$51 million bond that comes due in 2022, Jose Rojas, the vice president of finances at the Venezuelan state oil company, said in a statement Friday.

The bond was sold with a 5.875% coupon, below original estimates that ranged from 6.125% to 6.5%, according to the statement.

Rojas said the bond sale "marks a highly positive sign in the financial market," and that the proceeds from the bond sale will be used pay down a \$65 million bank loan coming due in 2006.

Petroleos de Venezuela S.A. (PVZ.YY) and *Amerada Hess* (AHC) each hold a 50% stake in the refinery, one of the largest in the Western Hemisphere with 495,000 barrels per day in production.

Ecuador's State-Run Oil Co Takes Steps to Boost Output

BY MERCEDES ALVARO

QUITO (Dow Jones)—Ecuador's state-run oil company will invest between \$25 million and \$50 million this year to rehabilitate 50 inactive wells, allowing the company to boost production to about 210,000 barrels per day by December.

Petroecuador's production, which has been on the decline in recent years owing to inadequate investment levels, currently stands at 196,000 barrels per day.

Energy Minister Eduardo Lopez, who took over the post earlier this month, announced the investments as part of a new government oil policy, which he characterized as aggressive and long-term.

According to Lopez, the rehabilitation work will begin in May. A committee has been established to

evaluate the state of the wells and determine what type of reconditioning is needed to make them functional.

To finance the program, the energy ministry will instruct Petroecuador's production unit to reclassify certain budget items for investment purposes.

Lopez also said that the government seeks to attract private investment to carry out projects at the Ishpingo-Tambococha-Tiputini and Pungarayacu fields, which have combined reserves of 3 billion barrels.

The minister also said that new oil field auctions would be carried out in the context of the reforms to the Hydrocarbons Law that is currently before congress.

Indonesia Eyes July 1 LNG Deal for Baja, California

BY JOHN M. BIERS

HOUSTON (Dow Jones)—The Indonesian national petroleum company expects to finalize by July 1 a contract with *Sempra Energy* (SRE) to supply liquefied natural gas (LNG) to a proposed terminal in Mexico, an executive said Monday.

The Indonesian company, *BPMIGAS*, which has already finalized sales agreements with China and South Korea for some of the LNG, is "still under negotiations" with Sempra, said Djoko Harsono, head of *BPMIGAS's* marketing division.

BPMIGAS has relocated some community members and taken some other preliminary steps in beginning its \$3 billion *Tangguh* project in Eastern Indonesia, but the company hasn't started construction. The project, expected to begin operations in 2007, would liquify the gas, which would then be shipped to receiving terminals and regasified.

BPMIGAS has told funders of the \$3 billion *Tangguh* project in Indonesia that the company will route the gas to China if the Mexico deal falls through. However, Harsono said he was confident Sempra and *BPMIGAS* will reach a deal. "We don't want to build a big market in China because the pricing is quite low," Harsono said.

The two sides are discussing various possible terms, including options that would allow the supplier

or the buyer to reject up to 50% of the natural gas if they could achieve a better transaction elsewhere, Marsono said. In December, *BPMIGAS* signed a heads of agreement in Washington with Sempra and *BP* (BP) to supply 500 million cubic feet of LNG a day to a site in Baja, California in Mexico.

Gabriel Avgerinos, a general manager with consultant *Poten & Partners Inc.*, said oil companies have sanctioned about 55 million tons a year of capacity in the Asia Pacific region that so far has no market. As a result, Avgerinos said Asia Pacific is becoming a buyers market.

In these cases, oil companies will sanction a multi-billion LNG project with perhaps 50% of the capacity contracted and gradually sell more capacity as the project progresses. Avgerinos cited the *Sakhalin 2* project in Russia, which is operated by a consortium that includes *Royal Dutch/Shell* (RD, SC) and a unit of the *Mitsubishi Tokyo Financial Group Inc.* (MTF).

BPMIGAS hopes to reach by the end of 2003 a similar agreement with Mitsubishi and other proponents of a site in Long Beach, Calif., but that site has run into some local opposition. While the Mexico plant is "definite," the Long Beach plant is "still 50-50" in probability of being built, Harsono said.

Indonesia Offers Chile Gas to Offset Argentine Shortfall

BY STEPHAN KUEFFNER

SANTIAGO (Dow Jones)—Indonesia has offered Chile natural gas to help it offset its reliance on Argentine gas, Chilean President Ricardo Lagos said during an official visit to the Southeast Asian country Wednesday.

“We will continue negotiations with Indonesia regarding the possibility of joint undertakings between our (state energy company) *Empresa Nacional del Petroleo*, as well as on future possibilities regarding gas,” Lagos said in comments distributed by his office in Santiago following his meeting with Indonesian President Megawati Sukarnoputri.

“The possibility of importing Indonesian natural gas in the medium term would solve the (problem of) dependence on Argentine gas, introducing greater reliability for the whole country’s energy system,” the office added.

If that happens, it would be the second time Indonesia benefits from domestic issues preventing a Latin American country from capitalizing on its natural gas resources. Last December, the Asian country secured a deal to export to the U.S. after Bolivia failed to deliver on a similar deal owing to domestic political turmoil.

On Wednesday, Lagos issued a veiled warning to Argentina that it threatens to lose the most important market for its gas exports.

“Indonesia just recently concluded an accord to supply gas to the U.S. - to the state of California - and the corresponding investments are going ahead,” he said, alluding to Bolivia’s lost opportunity.

Argentine gas normally fuels some 30% of Chilean power generation. Chile is the destination of about 90% of Argentina’s natural gas exports.

In late March, Argentina froze natural gas exports at 2003 levels to stop a looming domestic energy crisis, while demand both there and in Chile has grown strongly and stands to continue increasing as both countries head into the Southern Hemisphere’s winter season, which this year has begun unusually early.

The resulting 20% shortfall in gas exports to Chile - starting at 3.3 million cubic meters a day - has left energy companies and politicians scrambling to replace the gas with other, more expensive fuels such as diesel and coal.

It has also strained normally close relations between the two countries, which share a roughly 5,000 kilometer border.

Chilean business leaders are scheduled to meet Argentine energy executives this week to discuss possible direct investments in Neuquen, the province that supplies most of the gas Argentina exports to Chile.

Bolivia recently agreed to sell natural gas to Argentina to offset some 5% of Argentina’s gas needs in the near term. As part of the deal, Bolivia forced Argentina to agree to keeping its limits on gas exports to Chile - further alienating the two countries from Chile.

Impoverished Bolivia has South America’s second-largest reserves, but its domestic market can absorb only a fraction of the supply, and expanding its exports would generate much-needed income. Territorial bickering has kept it from exporting gas to Chile, while exports to Brazil have fallen short of hopes.

Meantime, Lagos has come under fire from consumer advocacy and business groups and the right-wing opposition for depending too much on Argentine gas and for being too soft on the Argentine government.

Officials from the two countries are to meet Thursday to discuss energy issues, but at the same time, the Chilean government has been diplomatically active in seeking other energy sources.

In the month since the issue arose, Ecuador and Venezuela have also moved to capture some of the Argentine gas suppliers’ market, in part supported by Chilean diplomatic moves such as the removal of import duties on Ecuadorean oil.

Low investment in Argentina’s domestic gas sector, a lack of rainfall and a huge increase in energy demand have combined to produce Argentina’s worst energy crisis in more than a decade.

The companies blame a freeze in gas rates for the lack of investment and the boom in demand. The government blames the private sector for what it says have been years of failure to live up to contractual investment obligations.

Despite Lagos’ warm welcome for the Indonesian offer, he acknowledged it will take time for an agreement to take effect. “We’d have to undertake deeper studies and see what the possibilities for financing are for this project,” Lagos said.

Any deal with Indonesia would demand significant investments in infrastructure as the gas would be imported in liquefied form from across the Pacific rather than piped across the Andes.

Chile Seeks Investment in Argentine Gas Fields

BY STEPHAN KUEFFNER AND WAILIN WONG

SANTIAGO (Dow Jones)—Direct investment by Chilean companies in Argentine natural gas fields could help solve the ongoing supply problems, Chilean Foreign Minister Soledad Alvear said Sunday in an interview with *Radio Cooperativa*.

“The private sectors of both countries are involved in an important way and there is political will to accompany this effort. We will find joint solutions. The problem of the lack of fuel supply unfortunately affects both countries and the important thing is to find ways out” of the crisis, said Alvear after meeting Argentine peer Rafael Bielsa in Buenos Aires.

The investment would be in addition to Spanish-Argentine energy company *Repsol-YPF*'s (REP) existing plans to invest in increased production in that region.

Juan Claro, president of Chilean industrial manufacturers' association *Sofofa*, will meet Argentine officials to negotiate further terms, which would include investments in Neuquen province, source of most of the gas exported to Chile, Alvear added.

During the meeting, Argentina and Chile agreed to a new bilateral commission to resolve energy issues, the governments announced Saturday in a joint statement.

The creation of the *Ad-Hoc Bilateral Work Group*, as the committee was named, comes as relations between Argentina and Chile have chilled.

The two countries' joint statement said the new commission will focus on “reaching a shared vision on the energy situation and ... studying measures to confront the problems we face and seeking solutions to ensure regular supply for both countries.”

The group comprises four officials from Chile and three from Argentina and started meetings Saturday, the statement said.

The new-found harmony notwithstanding, Chile is considering seeking arbitrage in the crisis from the *Latin American Integration Association*, or Aladi, if the commission fails to reach a satisfactory deal within the next month, the *Associated Press* reported Monday, citing a foreign ministry source.

Additionally, Chilean legislator Jorge Tarud, a member of the lower house of Congress' energy committee, said Monday that “Argentina hasn't faced us. They, today, can't tell us how far they'll go, whether they'll continue cutting gas (exports) to Chile.” Tarud,

a member of the governing center-left coalition, said in an interview with *Cooperativa* that Argentina's willingness to sign a gas import deal with Bolivia that ruled out raising exports to Chile compounded the problem.

Bolivia earlier this week agreed to export natural gas to Argentina that will replace about 5% of the domestic shortfall in that country. However, it demanded Argentina keep its limits on gas exports to Chile so that Bolivian gas doesn't alleviate the domestic energy problems Chile faces.

Radio network website: <http://www.cooperativa.cl>

Brazil, Venezuela Mull Oil Exploration in Argentina

BY ADRIANA BRASILEIRO

RIO DE JANEIRO (Dow Jones)—Brazil and Venezuela are studying joint projects to drill for oil in offshore areas in Argentina, said Venezuela's Oil Minister Rafael Ramirez on Monday.

“We have been discussing that possibility and we have set up teams of technicians to discuss possible projects,” Ramirez told journalists at a gas and electricity congress in Rio.

The federally owned oil companies *Petroleo Brasileiro* (PBR) and *Petroleos de Venezuela SA* (PVZ.YY) would team up in the oil exploration efforts, Ramirez said.

The minister added that he was going to meet Monday with officials from Petrobras, but that the plans were still at an early stage.

In April last year, Brazil and Venezuela signed an agreement to broaden commercial ties and establish exploration, refining and production links between the state-run oil giants. Officials in Brazil and Venezuela said the agreement may lead to a refinery in Brazil's northeastern state of Maranhao, but haven't confirmed specific plans.

Petrobras owns oil assets in Argentina through its Argentine unit *Petrobras Energia Participaciones* (PZE). In 2002 Petrobras paid \$1.03 billion for a 58.6% stake in the company, formerly known as *Perez Companac*.

The Argentine company added oil, gas, refining, petrochemical and distribution interests to Petrobras' international asset portfolio.

Argentina Hints that Fuel Accord Should Stay in Place

BY LAURENCE NORMAN

BUENOS AIRES (Dow Jones)—Argentina's government has hinted that a 16-month-old fuel price accord should be renewed in its current form when it expires at the end of this week and shouldn't be adjusted upward because of the continued high international oil price.

The accord obliges oil producers to sell to refineries at \$28.50 per barrel, regardless of the international price. When the international price drops below that level, refiners will continue having to buy at \$28.50 until producers have recouped the foregone income.

The deal was first signed in December 2002, ahead of the war in Iraq and during a political crisis in Venezuela. It was intended to steady prices during that period and then be scrapped once those conflicts ended.

However, the high oil price has continued and refiners have now built up sizable debts with producers. As a result, both producers and refiners have pushed the government to allow producers to charge \$30 per barrel. Refiners, in turn, would lift prices, causing a slight hike in prices at the pump.

The government has so far refused to sanction this and Fuel Undersecretary Cristian Folgar suggested Monday in an interview with local radio station *Radio Uno* that Argentina will block any price rise.

Folgar explained that while the crude price has remained well above the \$28.50 price agreed, Argentina's peso has appreciated some 15% since the accord was first reached, which means producers are receiving more in local currency for that \$28.50 per barrel than they were at the end of 2002.

"We would have to work out the numbers exactly on one side and the other. But you don't only have upward (price) effects but also you have downward (price) effects, because the price in pesos has been maintained constant."

Asked if this could mean that the accord could lead to a fall in price, rather than the increase that refiners and producers want, Folgar responded: "No, what we are going to do is to have the discussion (with producers and refiners) with all these factors at our fingertips," he said.

Separately, Folgar denied suggestions that Argentina would face shortages of 10 million cubic meters of natural gas this winter, as part of its ongoing energy crisis.

Argentine media reported Monday that the association representing gas distributors had written to the government to express concerns that there will be massive gas supply shortages despite a series of government measures to resolve the crisis. The association, known as *ADIGAS*, reportedly said the shortages come from a lack of production, not a shortage of transport capacity.

Folgar admitted - as officials have already said - that industrial clients without guaranteed supply contracts will face bigger service cuts this winter than in the past, but denied that the problem was as big as *ADIGAS* suggested.

"It seems to me exaggerated in the sense that this isn't what distributors are going to lack in the peak days of winter, because obviously we are going to take all measures possible so that in the peak winter days, we can guarantee the non-interruptible demand. That's to say (supply) for residential users, for small businesses and for companies with guaranteed contracts," Folgar said.

Argentina is faced with gas shortages because of several years of low investment, coupled with 12 months of sharply increasing demand. Energy companies blame the low investment levels on a two-year rate freeze, while the government has accused energy companies of greed. The gas shortages have combined with low rainfall to create power shortages.

The government has unveiled a series of measures aimed at plugging the gas deficit, including rationing gas exports; importing power, diesel and natural gas from neighboring countries; and striking a deal with local producers to guarantee a certain supply level.

However, weather has continued to be a problem. After a dry summer, which left water levels unseasonably low, the weather has now turned suddenly cold, which will increase the use of gas. Analysts warn that if the weather is unusually harsh this winter the government may have to take a range of unpopular steps - like rationing power and gas use - to cope with the problems.

Argentina Provides a Second ARS200M Loan to Grid Operator

BY MICHAEL CASEY

BUENOS AIRES (Dow Jones)—The Argentine government will provide another ARS200 million (\$1=ARS2.8425) loan to the non-profit agency that runs the national power grid.

The loan is intended to help close a long-running deficit in a special fund used to compensate generators and to lower the risk of outages in power supply stemming from the current energy crisis.

A presidential decree published Tuesday in the *Official Bulletin* authorizes the national treasury to provide the second loan to the agency, known by its acronym *Cammesa*, following a similar decree last month authorizing an initial transfer of the same amount. The latest decree, which says it “takes into account the persistent state of social emergency with respect to the electricity sector,” should all but close the deficit in the so-called Stabilization Fund, which was last reported at ARS415 million before the loans were approved.

The deficit has posed a risk to the continuity of power supply because it meant generators weren’t getting paid for power supplied to Cammesa, which in turn channels it to power distributors. Because generators weren’t being paid, it was feared some generators might choose to shut operations when it became prohibitively expensive to run their plants, at a time when natural gas shortages threaten to drive costs dramatically higher.

The deficit in the fund first arose last year because the pricing mechanism designed to keep it afloat broke down.

The system was originally designed to include seasonal adjustments in the wholesale power price Cammesa charges distributors. In this way, it was supposed to smooth out that price over the course of the year in the face of otherwise volatile changes in season-to-season generation costs. However, the energy secretariat last year declined to raise the price at the normal review times. This was apparently because it didn’t want to raise residential power rates and thus end a politically popular freeze on utility rates. Such an action would have been required to give distributors the revenue-raising capacity needed to pay for the costlier power from Cammesa.

All this meant that when generation costs rose in the winter, when increased demand for natural gas creates shortages that force thermal generators to seek

out more expensive sources of fuel, Cammesa’s fund didn’t have the resources to pay for the higher spot power price demanded by the generators. As the winter dragged on and the generators’ non-gas costs rose, so did the deficit in the fund. The government repeatedly rejected generators’ demands that it lend money to Cammesa and instead made changes to the pricing system that would have denied generators the right to charge for non-gas generation costs and would have effectively shifted the deficit from Cammesa’s books onto those of the generators.

And now, with the additional problem of structural limitations in the national natural gas supply network, the imbalance between the funds available from distributors and the actual costs of generation is expected to be even greater in the coming winter, suggesting the deficit would otherwise rise even further.

But rather than exacerbate a situation that could prompt generators to shut down, the government is finally taking action. In addition to providing the loans to close the deficit arising out of last winter’s imbalances, it is planning to provide subsidies to generators whenever they are forced to rely on fuel oil and other expensive fuel sources in the event of gas shortages. The government anticipates a cost of ARS1 billion in these subsidies, which will continue, according to Fuels Undersecretary Cristian Folger, until electricity rates are restored to a level that will put the Cammesa fund back into balance.

Meanwhile, generators have been given another outlet for recouping their costs beyond that of the distributors plugged into the Cammesa system. Under a complex adjustment program laid out in February, the government set up a mechanism for generators to charge higher rates to large-scale industrial users of power.

And at the same time, it has taken action to boost the supply of gas, cutting imports to Chile and arranging for the import of 4 million cubic meters of natural gas per day from Bolivia. Along with a plan to import less costly fuel oil from Venezuela, it is hoped that all these measures will keep overall costs under control and persuade generators to keep operating. The pressure to achieve that will be even greater if an alliance of distributors is successful in a court motion they recently filed. The motion seeks a legal guarantee that

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power supply from Cammesa to distributors be unbroken.

Meanwhile, it is unclear how or whether Cammesa will eventually repay the ARS400 million it will borrow from the government. Even though both decrees

specify that the loans are to be repaid in full by the end of 2004 at an interest rate that complies with those of central bank certificates, local economic consultancy *MVA-Macroeconomia* noted in a research report last week that the first ARS200 million loan was accounted for in the national treasury's books as if the government didn't expect to be repaid for it.

Argentina's De Vido: Energy Saving Plan Covers Gas, Power

BY MICHAEL CASEY AND LAURENCE NORMAN

BUENOS AIRES (Dow Jones)—The Argentine government announced Wednesday the details of an aggressive plan to get consumers to conserve power and natural gas usage in an effort to confront the country's looming energy crisis.

The plan will include a scheme of incentives and sanctions based on consumption levels that will effectively mean that Argentine households will for the first time in 28 months face the prospect of higher rates for power and gas. Under emergency measures taken during Argentina's financial crisis in January 2002, utilities rates have been officially frozen.

In announcing the plan at a press conference alongside Planning Minister Julio de Vido and Energy Secretary Daniel Cameron, Cabinet Chief Alberto Fernandez said the plan would include a system of "rewards and punishments." These will be based on a comparison of users' current consumption levels with those of last year.

Energy Secretary Cameron said low-level consumers of gas and power, those categorized as "R1 and R2" users, will face no sanctions per se but will be rewarded with rate reductions if they consume less than they did in 2003. Larger users, which include big residential users and small businesses under the R3 category, will have a far more stringent set of rules, however. These will need to bring their consumption down to 95% of last year's levels if they are to avoid sanctions.

In terms of power, Cameron said the R3 category refers to any user that consumes more than 600 kilowatt hours. It is not clear how natural gas users in this category are defined.

Large industrial users are excluded from this plan because in both power and gas they are being moved over to a system in which they must sign individual contracts with electricity generators and with gas producers.

Cameron said the government's goal is to achieve overall energy savings for the country of between 5% and 7% off current consumption. It comes amid a recent crisis in gas supplies, which have forced the government to cut exports to Chile and take other emergency measures such as arranging with Bolivia for the import of 4 million cubic meters of natural gas per day.

The electricity sector has been roped into this problem because the gas shortages have threatened the efficiency of power generators, 50% of which are designed to run on natural gas. Power outages have from time to time been imposed on select industrial users and emergency power was imported from Brazil.

De Vido said the new plan would provide two economic benefits. Users would get a direct benefit in cost savings if they consume less, while there will be "an economic benefit to the entire industrial sector" if energy supplies can be preserved at levels that don't threaten continued economic expansion.

A copy of the decree later clarified that the plan will be in place for a year, which means that in mid-2005 residential and small business consumers will be encouraged to use less energy than they consumed two years earlier.

The decree also gave further details of the plan.

In the gas sector, for every unit of energy saved, clients will get a payment equivalent to the full cost of what they would have paid to consume that unit. The payment will be subtracted from the client's next gas bill. As for fines, clients will have to pay an extra 11 centavos (\$1=ARS2.8525) per unit of excess consumption, representing an increase of around 20% on the "normal" gas rate.

The exact nature of the fines and rewards for the power sector will be worked out by the Energy Secretary and announced in the coming weeks.

Brazil Restarts Southern Cone Energy Integration Talks

BY ADRIANA BRASILEIRO

RIO DE JANEIRO (Dow Jones)—The Brazilian government is leading a new round of talks with Southern Cone countries for energy integration projects that would start with a network of natural gas pipelines linking Brazil, Argentina and Bolivia, Brazil's Energy Ministry said Tuesday.

The current energy crisis in Argentina and political instability in Bolivia are the main factors stalling negotiations for an integrated system, but Brazil is resuming talks and wants state-owned companies such as *Petroleo Brasileiro* (PBR) to participate as investors, said Dilma Rousseff, Brazil's Energy Minister.

In a presentation at a power and gas conference Monday, Rousseff said that projects to transport natural gas - mostly through pipelines - are expected to consume about \$3.5 billion in the next few years.

Rousseff said that one of the projects is a new pipeline to transport gas from Bolivia to Argentina. The minister explained the new pipeline could be linked to the 3,150-kilometer Bolivia-Brazil gas pipeline, which started operating in 1998. The pipeline, which

is expected to cost \$1 billion, would transport 10 million cubic meters of natural gas a day starting in mid-2006, and would gradually increase its capacity to 20 million cubic meters a day by 2010.

Another project announced earlier this month by the governments of Brazil and Bolivia is to build a binational gas-chemical complex to boost energy integration in South America and add value to Bolivian natural gas. The project is estimated to cost \$1.3 billion, and is expected to start production in 2009, Rousseff said.

Energy specialists are skeptical about plans for energy integration. They say the countries have many hurdles to resolve individually before even attempting integration projects.

An integrated system would involve a wholesale power, gas and oil market for the Southern Cone operating under a set of agreed rules and prices, including a free market framework which would attract investors. The Southern Cone encompasses Argentina, Brazil, Chile, Uruguay, Paraguay and Bolivia.

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Borrowers need to be aware that the Brazilian Central Bank will not grant prior approval for prepayment of the debt. Thus, even though a foreign loan agreement may contain a prepayment provision authorizing the borrower to prepay the loan, the borrower will only be able to obtain the Central Bank authorization for prepayment at the time that such amount is due. Moreover, Central Bank regulations limit the amount of default interest rate to one percent per annum, except in cases where the default interest rate relates to foreign governmental agencies and international organizations.

Where the project financing involves import transactions (such as cross-border leases and charters with a term greater than 360 days) it is also necessary to register such transactions in accordance with the on-line Integrated Foreign Trade System (*Sistema Integrado de Comércio Exterior*—SISCOMEX), which in turn is interconnected with the Central Bank's on-line system, SISBACEN. The Central Bank approves a cross-border lease through the electronic issuance of a ROF, pursuant to Ordinance 2731, dated December 13, 1996. Prior to obtaining approval of a ROF and the shipment

of goods into Brazil, the Brazilian importer/lessee must obtain from the Foreign Trade Secretariat (*Secretaria de Comércio Exterior*—SECEX) an Import License (*Licença de Importação*—LI).

Generally, after approval of a ROF and upon customs clearance in Brazil, the Brazilian importer/lessee must obtain an Import Declaration (*Declaração de Importação*—DI) from the Foreign Trade Secretariat in order to have its schedule of payments, under the lease, linked to an approved ROF. With such authorization, it may remit offshore any principal and interest relating to the lease transaction.

Brazilian National Register of Legal Entity (CNPJ)

Since August 2002,² any foreign company with investment in the country (i.e. assets, stocks, vessels), and any foreign bank lending money to a Brazilian company or a foreign lessor, shall be registered with the Brazilian National Register of Legal Entity (CNPJ) of the Brazilian Federal Revenue Office. Such registration follows the trend toward supervising transactions conducted by non-residents.³

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Foreign Equity Investment

Foreign equity investment in Brazil must also be registered before the Brazilian Central Bank in accordance with SISBACEN, as per Ordinance 2997, dated August 15, 2000. Prior to the movement of funds, the initial investment registration (*Registro Declaratório Eletrônico – Investimento Externo Direto—RDE-IED*) and its updating registration number must be included in the currency exchange contract. In addition, the foreign shareholder of a Brazilian special purpose company must name a legal representative in Brazil. Both the legal representative and the Brazilian special purpose company remain responsible for furnishing corporate and personal information, registering and updating the system on the status of the investment in the Brazilian company. The RDE-IED shall be obtained within 30 days from the relevant trigger event or, in case of tangible assets, within 90 days from custom clearance of the asset.

Bankruptcy, Transfers and Security Interests

As in all project financing arrangements, the parties enter into detailed agreements regulating the distribution of payment, defaults, rights to cure defaults, voting and the enforcement of security. Several issues relating to Brazilian practice mandate specific attention in this regard. First, the project financing arrangement does not supersede Brazilian bankruptcy legislation that defines security interest priorities. Second, lenders generally wish to have the collateral transferred in the event of default. As the collateral (i.e. an oil and gas concession) may not be transferred without the consent of the ANP, typical foreclosure and transfer provisions may not be valid. Third, certain security interests, such as floating charges, have lim-

ited application, and other security interests are only valid if prescribed procedures are strictly followed.⁴

Conclusion

The Brazilian government is encouraging foreign private infrastructure investment. The foreign exchange control regulation and the on-line declaratory system (including the RDE-IED) demonstrate Brazil's commitment toward simplifying government formalities in connection with capital inflow and outflow.⁵

Endnotes:

- (1) This applies whether or not such payment obligations are registered with the Brazilian Central Bank.
- (2) Brazilian Federal Revenue Office Normative Ruling 167, of August 14, 2002, revoked by Normative Ruling 200, of September 13, 2002, and Normative Ruling 312, of March 28, 2003.
- (3) Foreign companies are not subject to tax liability under these rules.
- (4) While judicial proceeding is required for the enforcement of a security interest, under certain instances a non-judicial, private sale is permitted where a contract explicitly provides that assets can be privately sold to enforce a pledge.
- (5) Although the foreign exchange control policy is a declaratory system, the parties must maintain all documents related thereto for a period of five years after termination of the transaction and, if requested, make such documents available to the Central Bank.

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Brazil's New Alternative Energy Incentive Program

BY CHRISTIANE SCABELL HÖHN AND PLÍNIO SIMÕES BARBOSA
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Brazil recently launched a program to foster private investments in the production of energy from alternative sources, the PROINFA - Alternative Energy Sources Incentive Program. The program benefits wind energy, PCHs (i.e., hydroelectric plants of up to 30 MW) and biomass projects. Selected private producer projects will be ensured special long term power purchase agreements with the *Centrais Elétricas Brasileiras S.A.* (Eletrobrás), providing for the supply of energy at predetermined prices.

Originally created by Law No. 10,438, of April, 2002, PROINFA lacked certain regulatory definitions until Decree No. 5,025 was enacted, in March 2004. The first round of PROINFA will benefit projects with an aggregate capacity of up to 3,300 MW, equally divided amongst wind energy, biomass and PCH projects. This is expected to double the participation of such three alternative sources in the total electric energy production in Brazil, and the corresponding projects may also qualify for Kyoto Protocol treatment.

Banco Nacional de Desenvolvimento Econômico e Social (BNDES), the Brazilian development bank, will finance in local currency up to 70% of the total amount to be invested in the PROINFA projects. Meanwhile Eletrobrás will, during the financing period, ensure payment to the relevant producer, also in local currency, of at least 70% of the energy contractually acquired, even if the producer does not deliver such quantity in any given period. Funding and sale of energy in local currency reduces the foreign exchange risk, which is always a problem in long term agreements.

The BNDES credit line for PROINFA projects amounts to R\$ 5.5 billion (approximately US\$ 1.9 billion). The facility agreement will provide an amortization period of 10 years and a grace period of six months counted from the start of operations. BNDES interest rates are lower than the rates otherwise available in the Brazilian market.

The prices for the acquisition of the electric energy generated by PROINFA projects vary according to the source of energy. Actual prices were established by Resolution No. 45/2004 recently enacted by the Mines and Energy Ministry and exceed the minimum amounts provided for by Law No. 10,438/2002. Ac-

ording to the recent Resolution, Eletrobrás will pay R\$ 117.02 per MWh generated by PCHs (equivalent to approximately US\$ 40.21 per MWh). For biomass plants the price will vary according to the product used, as follows: R\$ 93.77 (US\$ 32.21) for energy generated using sugar cane residues; R\$ 101.35 (US\$ 34.82) for wood chips; R\$ 103.22 (US\$ 35.46) for rice peel; and R\$ 169.08 (US\$ 58.10) in the case of garbage biomass. Wind energy will have prices varying from a minimum of R\$ 180.18 (US\$ 61.91) to a maximum of R\$ 204.35 (US\$ 70.22), depending on the nominal capacity of the wind farm.

The above-mentioned prices are subject to increase according to the IGP-M/FGV, a general price index calculated by the *Getúlio Vargas Foundation* of Rio de Janeiro, over the 20-year term of the power purchase agreement with Eletrobrás.

Eletrobrás has already published the first Public Bid to select projects under PROINFA rules. Interested producers should present to Eletrobrás the necessary documentation by May 10, 2004. In this first stage, Eletrobrás should observe the limits of 220 MW of wind and biomass alternative sources and 165 MW of PCHs per Brazilian State. If, however, after the selection process, Eletrobrás is not able to acquire all of the 3,300 MW of energy, Eletrobrás will be authorized to acquire energy without regard to said limits.

Law No. 10,762/2003 contemplates a second round of PROINFA, which is not yet entirely regulated. However, the rules for such second round may not be as favourable as those mentioned above. For example, the local content requirement may be raised from the 60% that applies to the first round to as high as 90%. Energy prices may also be lower, even though the independent power producer might be entitled to an additional credit, depending on the source of energy.

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Brazil Electricity Sector

Brazil's Power Sector Regulation Delayed until June

BY ADRIANA BRASILEIRO

RIO DE JANEIRO (Dow Jones)—The announcement of regulation for Brazil's power sector has once again been delayed, adding fuel to criticism that the government isn't taking the necessary steps to ensure private investment in the cash-strapped sector.

Brazil's Mines and Energy Ministry said Wednesday that new regulation, which will detail two presidential decrees implementing sweeping reforms to the power sector, is now expected to come in June.

Approved in the Senate in early March, the so-called Executive Decree 144 introduces new guidelines for the electric sector, while another decree, called 145, creates a new state-controlled company, which will be in charge of long-term planning in the sector.

Originally, regulation to detail the guidelines, which investors thought were too vague, was expected in April or May.

The new model for the electricity sector is expected to clear up messy legislation and keep a lid on utility

prices as power trading will take place in a regulated electricity pool. Brazil's government hopes the combination of a solid regulatory framework with more efficient strategic planning will pave the way for investments.

But investors aren't happy with the guidelines in the decrees and are anxiously waiting for the new regulation, hoping that will improve risk perception in the sector.

One key point of disagreement is the different treatment given to so-called "old" electricity from power plants whose investments have been amortized, and "new" power from recent projects. The model calls for separate auctions for each segment on a regulated electricity pool.

Power sector representatives have also lobbied the government to change tariff mechanisms to allow distributors to pass on to consumers a larger part of the risks and costs they have with power purchases.

Brazil's Rousseff Confirms Eletronorte CEO for Eletrobras

BY ADRIANA BRASILEIRO

RIO DE JANEIRO (Dow Jones)—The chief executive of Brazil's federally owned generator *Eletronorte* will replace Luiz Pinguelli Rosa at the helm of federal electricity holding *Centrais Eletricas Brasileiras* (ELET6.BR), a top government official said Monday.

Brazil's Mines and Energy Minister Dilma Rousseff confirmed Silas Rondeau as the new president of Eletrobras, as the holding is known. Eletronorte is a unit of Eletrobras.

Rondeau has long been rumored as the replacement for Pinguelli in a political rearrangement in the government. That process has involved months of behind-the-scenes negotiations to accommodate Brazil's centrist *Democratic Movement Party*, or PMDB, one of Brazil's largest parties, within the administration of Luiz Inacio Lula da Silva.

Rondeau has the support of Senate President Jose Sarney, who has been credited with shielding Lula throughout a political scandal involving Chief of Staff Jose Dirceu and is a key force in the governing coalition.

Rousseff said Rondeau will take his new position by mid-May. The new chief executive of Eletronorte

will be Roberto Salmeron, planning director at Eletrobras, Rousseff added.

Eletrobras controls generation and transmission companies throughout Brazil, including Eletronorte, *Chesf*, *Furnas*, *Eletrosul*, *Eletronuclear*, the *CGTEE* thermal generation company and the huge *Itaipu* hydroelectric plant on the border with Paraguay. The Eletrobras generation system is responsible for about 60% of the energy produced in the country.

In afternoon trade, Eletrobras' more liquid preferred shares were 0.98% lower at 36.50 reals (\$1=BRL2.9) while the main Ibovespa index lost 1.08%.

Rousseff said that any changes at federally owned oil giant *Petroleo Brasileiro* (PBR), or Petrobras, will come after the announcement of its new strategic plan, expected in May.

"Some changes will take place, but I can't name any names now," the minister told journalists at a gas and power conference in Rio.

Recently, speculation has mounted that Rogerio Manso, supply director at Petrobras, will be asked to resign to make way for a political appointment. His successor is also expected to be named by the PMDB.

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prices that are comparable to those paid by competitors in other countries. However, the participants of project finance deals, including government entities, sponsors, commercial lenders, export credit agencies, multi-lateral institutions, contractors and operators will continue to be subject to traditional legal, financial, operational, commercial, and political risks.

Conducting Due Diligence and Identifying Project Risks

Due diligence is a critical process in which project finance participants identify those elements that expose the project to risks. These elements must be addressed and carefully evaluated, in order to lead to successful financing of the project.

Site Selection

As project financings typically have a significant real estate component, the selection of an adequate site to host an energy project is the first step towards success. Before a site is selected, it is important to perform due diligence in order to verify the legal feasibility of the project from the perspective of zoning and land-use regulations. In Mexico, transfer of title is done through a civil law Notary Public, and before issuing a title deed, a Notary Public is required to make a title search in the Public Registry of Property (*Registro Público de la Propiedad*). However, after obtaining from the Public Registry of Property a no-lien certificate, a Notary Public transcribes in the title deed the meets and boundaries of the land, but without performing a thorough title chain search and analysis. The irregu-

Private Investment in Mexico's Energy Sector: Legislative Background

In 1992, Mexico's Electric Energy Public Service Law (*Ley del Servicio Público de Energía Eléctrica*) was amended to allow private investment in power generation activities that do not constitute a "public service". Under the aforesaid amendments, there are only certain specific activities related to the generation, transformation and supply of electric energy which are not considered as public service and which may be carried out by individuals or corporations. Those activities are: (i) generation of electric energy for self-supply, co-generation or small production (generation of electric energy which shall not exceed 30 Megawatts); (ii) generation of electric energy by independent producers for its sale to the Federal Electric Energy Commission (*Comisión Federal de Electricidad—CFE*); (iii) generation of electric energy for its exportation, deriving from co-generation, independent production and small production; (iv) importation of electric energy by individuals or corporations for their own needs; and (v) generation of electric energy to be used in emergencies arising from the interruption of the public service.¹ The aforesaid amendment changed the definition of public service² without modifying the Constitution.

Likewise, in 1995 the Law Regulating Article 27 of the Constitution concerning Petroleum Activities (*Ley Reglamentaria del Artículo 27 en el Ramo del Petróleo*) was amended in order to allow private investment in warehousing, distribution and transportation of natural gas.

These reforms allowed the federal government to resolve its short term power generation limitations and needs. However, they have proven to be insufficient given Mexico's prospects for growing development.

It is estimated that over the next ten years electricity demand will grow by 5.6% per year, while power generation capacity for that period is expected to increase at an average of 4.8%. In a conservative scenario of growing development, the increased demand in electric energy will require the installation of 32,000 megawatts of generating capacity. Considering the current need for investment in Mexico's energy sector and that the Mexican government is limited by a tight public budget, several attempts have been made to reform the energy sector.

In 1999, former President Zedillo sent to Congress a bill which proposed to: (i) Modify Articles 27 and 28 of the Mexican Constitution in order to terminate the State's monopoly in all activities related to the public service of electricity; (ii) Privatize the assets belonging to the state-owned utilities, CFE and *Luz y Fuerza del Centro* (LFC); (iii) Auction to private investors all distribution networks owned by CFE and LFC; and (iv) Concession the transmission system to a single private entity which would not participate in generation and distribution activities. Nonetheless, Mr. Zedillo's initiative was not approved by Congress due to the opposition from political parties, as well as the labor unions of CFE and LFC.

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larities that have been found in the Public Registries of Property throughout Mexico have caused concerns among investors. In order to address this type of risk, an investor would be well advised to perform a land survey, define the meets and boundaries set forth in the title deed, and purchase title insurance. Although title insurance has not been utilized in Mexico to a great extent due to the role of civil law Notaries, it is now available for real estate transactions through Mexican agents of American title insurance companies.

If the site selected is located at communal ownership real estate (*ejido*), a procedure governed by the

Agrarian Law (*Ley Agraria*) and its regulations must be complied with in order to privatize and purchase the land from communal owners (*ejidatarios*). In order to privatize communal ownership lands, (i) the majority of the parcels of the communal ownership real estate are required to be delimited and assigned to the communal owners; (ii) the meeting of communal owners must issue a resolution whereby communal owners agree on the private ownership of the parcels; (iii) the former communal owners are required to request the cancellation of the registry of the land as communal ownership before the National Agrarian Registry (*Registro Nacional Agrario*), which will issue a new title

In May 24, 2001, President Fox amended the Regulations of the Electric Energy Public Service Law (*Reglamento de la Ley del Servicio Público de Energía Eléctrica*). The amendments increased the amount of excess electricity production³ that independent power producers are allowed to sell to the CFE, without the CFE being obligated to purchase this electricity by means of a public bidding process. The Permanent Commission of the Mexican Congress filed before the Supreme Court a constitutional challenge to the amendments. In an unprecedented decision, the Supreme Court concluded that these amendments were unconstitutional, arguing that the Fox administration had exceeded its regulatory authority by establishing regulations that exceeded the limits set forth by the Electric Energy Public Service Law regarding production and sale of electric energy by private permit holders.

In August 16, 2002, President Fox submitted to Congress a bill of amendments to the Constitution and to the Electric Energy Public Service Law. The bill of amendments, which included modifications to Articles 27 and 28 of the Mexican Constitution, proposed, without privatizing the assets owned by the state-owned utilities, to:

- (i) Allow large qualified consumers (who use at least 25,000 megawatts per year) to purchase electric energy either from private permit holders or state-owned utilities (CFE and LFC) by obtaining a registry issued by the Energy Regulatory Commission (*Comisión Reguladora de Energía—CRE*). Therefore, the generation, importation, conduction, transformation and direct or indirect sale of electric energy to this class of large electricity buyers would not be deemed as a public service;

- (ii) Guarantee access and non-discriminatory use of the national transmission and distribution grids, to assure that consumers who are not supplied by state-owned utilities have access to the electric energy they purchase;
- (iii) Grant CFE managerial autonomy through the enactment of an Organic Law of CFE (*Ley Orgánica de la Comisión Federal de Electricidad*) in order to increase the utility's efficiency and competitiveness;
- (iv) Transformation of the National Center for Control of Electric Energy (*Centro Nacional de Control de Energía*), which currently depends on CFE, into a decentralized public entity. The decentralization would allow this entity its own legal capacity and operational autonomy, and the National Center for Control of Electric Energy would be responsible, among other functions, for providing access and non-discriminatory use of the national transmission and distribution grids.

Other political parties, such as the *Partido de la Revolución Institucional* (PRI) and *Partido de la Revolución Democrática* (PRD) have also submitted to Congress proposals to reform the electricity sector. Recently, at the request of Senators Manuel Barlett and Salvador Rocha, the Federal Auditor (*Auditoría Superior de la Federación*)⁴ has reviewed the legality of the permits issued by the CRE. The foregoing events coupled with the abovementioned constitutional challenge of the Regulations of the Electric Energy Public Service Law, have obviously created legal uncertainty among investors.

deed to be registered before the Public Registry of Property (*Registro Público de la Propiedad*)⁵. Furthermore, if the communal ownership real estate is being sold for the first time, then the Agrarian Law grants the right of first refusal to the relatives of the communal owner. These include peasants who have worked the land for a period exceeding one year and communal owners who own parcels in the communal ownership real estate. The right of first refusal must be exercised within 30 (thirty) calendar days after the date in which the seller notifies in writing its intention to undertake the sale. If the seller fails to make the aforesaid notification, the sale of land shall be null and void.

Environmental Impact Assessment Authorization

Any entity intending to perform activities that may cause environmental imbalance or exceed the limits and conditions provided for in the environmental regulations must obtain an environmental impact assessment authorization from the Environmental and Natural Resources Ministry (*Secretaría de Medio Ambiente y Recursos Naturales*—SEMARNAT). In order to obtain the aforesaid authorization, an environmental impact assessment for the project has to be submitted before SEMARNAT along with the strategies to be implemented in order to avoid, mitigate and compensate any environmental impact. Under Mexican environmental regulations, the owner or possessor of a polluted land is presumed to be the polluter, unless it is demonstrated that previous owners were the responsible parties of such pollution. Consequently, the participation of qualified and sophisticated environmental experts is always recommended.

Public Works Agreements

If the assets associated with the project will be owned by federal or local entities, or by entities of the federal or local public administration, public works, purchases, leases, as well as services contracted, should be made through a public bidding process, in order to assure the best conditions as to price, opportunity, quality, financing and other relevant conditions⁶. Project finance participants should take into consideration that under the law governing public works, the entities of the public administration may be entitled to terminate in advance the public works agreement for “general causes”⁷, in which event the entity of the public administration shall only pay the executed

works as well as reasonable and documented non-recoverable expenses incurred by the contractor.⁸

Government Permits and Authorization

The due diligence review should also be focused on the permits and governmental authorization that are necessary to implement the project. Such review should focus on the issues that may have some sort of effect on or pose a risk to project finance participants, including the lenders financing the project. These issues include:

- (i) the term required for the granting of the permit;
- (ii) obligations assumed by the permit holder;
- (iii) maximum rates that the permit holder will be allowed to charge;
- (iv) whether the permit holder is in compliance in all material respects with such permit;
- (v) assignment provisions of the permit; and
- (vi) termination and revocation provisions.

Whatever the outcome of Mexico’s energy reform, the participants of project finance deals...will continue to be subject to traditional legal, financial, operational, commercial, and political risks.

Collateral Assets and Security Interest Mechanisms

In connection with the security package that will secure financing, lenders have to assess and decide what kind of assets and rights should be included. Considering that cash flows or receivables generated by the project can be used as collateral, lenders should take into consideration the existence of rate regulations.

If the project being financed is the construction of a pipeline, lenders should be aware that rates for natural gas transportation services are governed by: (i) the Natural Gas Regulations (*Reglamento de Gas Natural*); (ii) the Natural Gas Tariff Guidelines (*Directivas sobre la determinación de precios y tarifas para actividades reguladas en materia de gas natural*); (iii) the corresponding gas transportation permit and the general conditions forming a part thereof. Such documents set forth

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a series of principles amongst which the following should be highlighted: (i) rates authorized by the Energy Regulatory Commission for the rendering of gas transportation services will be the maximum rates; (ii) permit holders may agree with their clients on rates different to the applicable maximum rates as long as such rates are not less than the variable costs incurred in rendering the service; and (iii) maximum rates will be globally reviewed and adjusted by CRE.

Regarding the possible assignment of the permit as collateral for project financing, lenders should take into consideration the requirement for such assignment under Mexican law. Pursuant to the provisions of the Natural Gas Regulations (*Reglamento de Gas Natural*), gas transportation, warehousing, and distribution permits may be pledged or otherwise used as collateral to secure obligations or financing incurred for the rendering or extension of such services. In order to create a security interest in such permit, the permit holder must notify the CRE at least ten days in advance. A security interest created on a permit or rights thereunder for purposes other than those described above requires the approval of the CRE.

In light of these considerations, the structure of the security package will be project specific. Under Mexican law, the most common security interest mechanisms used in project finance are the following:

Guaranty Trust

Under the guaranty trust, the settlor transfers to a trustee title of the tangible or intangible assets that will form the trust state, in order to guarantee to the trust beneficiary the fulfillment of an obligation and its preference in payment. Any kind of rights and property may be subject to a guaranty trust including:

- real estate;
- personal property;
- equipment;
- inventories;
- account receivables;
- permits;
- concessions and authorizations to the extent that they can be pledged;
- shares representing the capital stock of the special purpose entity which owns the assets associated with the project; and
- the right of the debtor to receive any amounts payable by insurance companies under the relevant insurance policies.

One of the main benefits of the guaranty trust is the possibility that the parties have to contractually establish their own rules of foreclosure, including out-of-court foreclosure. The other benefit is that, if the debtor is declared in bankruptcy, the trust state will not be subject to bankruptcy given the fact that by executing the trust, the settlor has transferred to the trustee the assets that form the trust state.

Pledge Without Dispossession

Recent amendments to Mexican laws allow the possibility of creating a pledge without transfer of possession. Under this scenario, the debtor is allowed to use the pledged assets as part of its productive process, or to sell them within the normal course of its business activities, in which event the proceeds of the sale are subject to the pledge. A pledge without transfer of possession creates a right over assets to guarantee the performance of an obligation and its preference in payment, in which the debtor retains physical possession of the pledged assets. The above is an exception to the general rule governing pledge agreements in Mexico under which the creditor generally receives possession of the pledged assets. Under Mexican law, a pledge is a real guarantee covering movable assets, in which the guarantee grants a preferential right with respect to collection of debts of third parties vis-à-vis the asset constituting the guarantee itself, even in the event of bankruptcy of the debtor. A pledge without dispossession may also be enforced by means of an out-of-court foreclosure.

Industrial Mortgage

Pursuant to the provisions of the Law of Credit Institutions (*Ley de Instituciones de Crédito*), the industrial mortgage encumbers the “complete unit” of an industrial, agricultural or service enterprise. The mortgage will extend to all the assets of the debtor including the concession or license, real estate and personal property, money in bank accounts, account receivables and all other collection rights originated by the business operation. However, the use of industrial mortgage in a security package is generally limited to Mexican banking institutions, and a similar form of mortgage is only contemplated in certain state or local civil codes.

Stock or Partnership Interest Pledge Agreement

As collateral security for the fulfillment of obligations and its preference in payment, the shareholders or partners of the special purpose entity which owns

the assets associated with the project, may grant a lien on the shares or partnership interests representing the capital stock of such special purpose entity.

Except for the execution of a guaranty trust or a pledge without dispossession, foreclosure of a security interest requires the beneficiary thereof to initiate a court procedure, which is generally a time consuming process. It is still argued that any type of out-of-court foreclosure may violate due process guarantees that are set forth in the Mexican Constitution. Adequate selection of jurisdiction and competent courts is critical.

Conclusion

In summary, the enactment of new energy regulations should open new investment opportunities and grant legal certainty to investors. However, project finance participants should always consider other types of legal risks, some of which have been highlighted herein.

Endnotes:

- (1) Article 3 of the Electric Energy Public Service Law.
- (2) Pursuant to Article 4 of the Electric Energy Public Service Law, the public service of electricity includes generation, conduction, transformation, distribution and sale of electric energy.

(3) The amendments to the Regulations of the Energy Public Service Law define excess electricity production as the remaining electricity production after the private permit holder has satisfied its own needs.

(4) The Federal Auditor (*Auditoría Superior de la Federación*) is an entity of the Chamber of Deputies (*Cámara de Diputados*) who is in empowered, among other responsibilities, to audit entities of the federal public administration.

(5) Pursuant to the provisions of the Agrarian Law, if a Notary Public authorizes a public deed whereby communal ownership land is privatized, it is obligated to notify the National Agrarian Registry.

(6) Article 134 of the Mexican Constitution (*Constitución Política de los Estados Unidos Mexicanos*).

(7) This is a broad and vague term; there are not many precedents defining this term.

(8) Article 60 of the Federal Public Works Law (*Ley de Obras Públicas y Servicios relacionados con las mismas*)

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Chile's Mar Electricity Output +2.6% on Year to 4,039 GWh

BY STEPHAN KUEFFNER

SANTIAGO (Dow Jones)—Chilean utilities generated 4,039 gigawatt hours of electricity in March, a 2.6% increase from the same month a year earlier, the *National Institute of Statistics*, or INE, said Wednesday.

Electricity generation in the *Sistema Interconectado Central* grid, or SIC, which covers the heavily populated central region of the country, totaled 2,872 GWh during the month, 71.1% of total electricity generation. INE didn't provide information on the percentage change in electricity generation for the SIC from the year-earlier period.

The central grid supplies electricity to the majority of Chilean homes and industries. The principal generation companies supplying energy to the grid are *Empresa Nacional de Electricidad SA* (EOC), *AES Corp.* (AES) through its Gener subsidiary, and *Empresa Electrica Colbun Machicura SA* (E.EEC).

INE didn't break down electricity generation by individual companies.

Generators in the *Sistema Interconectado Norte Grande* grid serving northern Chile produced 933 GWh of electric-

ity, or 23.1% of the total, in March, while imported power amounted to 3.8%.

Generation increased as the local economy heats up and also heads into winter - and suffers from cuts in Argentine natural gas deliveries, with the North the area hardest hit.

In late March, Argentina froze natural gas exports at 2003 levels to stop a looming domestic energy crisis, while demand both there and in Chile, the destination of about 90% of Argentine gas exports, has grown strongly and stands to continue increasing as both countries head into the Southern Hemisphere's winter season, which this year has begun unusually early.

The resulting 20% shortfall in gas exports to Chile - 3.3 to 4.3 million cubic meters a day - has left energy companies and politicians scrambling to replace the gas with other, more expensive fuels such as diesel and coal.

Argentine gas normally fuels about 30% of Chilean power generation.

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