

Bolivia's Upcoming Referendum and Its Impact on Future Hydrocarbons Politics

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Background

Up until the mid-1990's, many industries in Bolivia—such as the airline, hydrocarbons, telecommunication, and electricity industries—were under monopoly control of the Bolivian government. Due to the financial burden of administering these industries, coupled with the country's low credit rating, the government at the time determined that it was necessary to provide investment incentives and attract private capital for the development of all state-run industries. In this manner, the Bolivian economic policy of those years became geared towards market liberalization and the participation of national and international private capital through a process of privatization.

This process was very successful at first, given the large amounts of capital that entered the country, facilitating the advanced development of many newly privatized industries. For example, Bolivia's hydrocarbons industry benefited as the recipient of over 40% of the total private capital invested in Bolivia, with

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Commentary: Investment Conditions in Brazil's Hydrocarbons Sector

BY HUGO SIGELMANN
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Introduction

In an article published in the December 11, 2003, issue of *Latin America Energy Report*, it was reported that the Secretary of Oil and Gas within the Brazilian Ministry of Mines & Energy admitted that the 5th Bidding Round did not attain its objectives. The local industry and other publications in general have been more crushing in describing the result of the 5th Round.

In view of that experience, what hope is there that the outcome of the 6th Bidding Round, scheduled for August 2004, may be better? There seems to be no reason for exaggerated optimism. This article highlights the obstacles that international oil investors may encounter in Brazil's hydrocarbons sector, through participation in the upcoming 6th Bidding Round as well as through other investment activities in the sector.

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Highlights

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The Rise of Petrobras

Petróleo Brasileiro S.A. (Petrobras), celebrating its fiftieth anniversary this year, was founded in the midst of heated and highly controversial debates, among vigorous public demonstrations, tending to reaffirm a nationalist ideology based on the famous slogan “the oil is ours”. Those were Cold War times, but one should note that this nationalist attitude persists in Brazil’s collective subconscious.

Petrobras has been an undeniable success. Today it ranks among the world’s largest companies, although skeptical analysts argue that, due to the lack of comparables, the efficiency of monopolies, by definition, cannot be assessed. Despite the fact that the cost of the monopoly to the Brazilian economy may be unknown, it is clear that Petrobras’ operating performance should allow Brazil to achieve self-sufficiency in oil between 2006-2007. At present, Brazil imports only about 15% of the oil it consumes.

Private companies operating in Brazil’s hydrocarbons industry... have admitted that the presence of Petrobras in the market changes the balance between the public and private sectors.

In spite of the acclaimed success of this private and public joint stock corporation (Petrobras has a large number of private stockholders), many economic circles insist that the opening up of oil prospecting to private capital can only bring benefits to Brazil.

However, only President Ernesto Geisel (1974-1979), during successive military governments, accomplished that feat, despite stiff resistance from the so-called nationalist sector, of attempting a timid opening, which authorized Petrobras to sign “service contracts” (“risk contracts”) with foreign prospecting companies. These foreign oil companies then began to operate in Brazil.

The constitutional reform implemented by President Fernando H. Cardoso in 1995 (Constitutional Amendment No. 6, of 08-15-1995), finally allowed private companies to enter directly, including those with foreign capital, into Brazil’s oil business, under the

framework as set forth in Law No. 9478, Art. 5, of August 6, 1997.

Risks to Foreign Investors in Brazil’s Oil Industry

The Strong Presence of Petrobras

Private companies operating in the Brazil’s hydrocarbons industry, however, have admitted that the presence of Petrobras in the market changes the balance between the public and the private sectors. First, Petrobras, due to its many years of activity in the region, knows the geology of Brazil better than anyone else, and its pioneer role clearly assures it the best positions, both operationally and politically. That would be a “natural” situation, so to speak. Secondly, Petrobras clearly gains political benefits from its government connection.

Nonetheless, the advent of a socialist government or, at least one in favor of state control, aggravated the situation, with state intervention affecting not only the oil industry but also other key sectors of the economy, including energy and telecommunications. The latter, during the Cardoso administration, underwent a wholesome privatization. The results were, without exaggerating, simply spectacular due to the strong presence of foreign investors.

Unfortunately, because the privatization of the energy sector was poorly handled, this sector did not experience such positive results.

Aside from the strong presence of Petrobras, the development of Brazil’s oil industry has also been upset by a series of specific factors that have gradually discouraged foreign investors. Whereas in 2001 Brazil had 45 drilling rigs employed, by the beginning of 2004 that number had dropped to 34 rigs.

Instability in the Regulatory Framework

A recurrent complaint, for example, concerns the instability of rules, especially in the taxation area, where there has already been some perception that Brazil is not competitive, when compared with other oil-producing countries.

From the investors’ point of view, the situation is compounded by technical factors such as 1) the small amounts of the oil discoveries, 2) the fact that the oil found was of the heavy type and had to be sought in ultradeep waters, leading to 3) costly and less interesting exploration.

Although investors consider the regulatory framework to be reasonable in general, unexpected prob-

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Brazilian E&P Royalty and Tax Implications: The Starting Point

BY ELISA SESANA AND ROBERTO CARNEIRO
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This article provides an introduction to the royalty and tax implications associated with acquiring and maintaining a Brazilian E&P concession, such as those that will be granted to successful bidders at the 6th Round to be held in August in Rio.

Federal Law No. 9,478 (The Petroleum Law), of August 6, 1997, established the conditions for oil and gas exploration in Brazil. The Petroleum Law mandates federal ownership of the country's oil and natural gas reservoirs, affirming the federal monopoly over production and exploration of these resources. Nevertheless, the Law grants ownership of oil and gas on a concession basis to companies producing the resources.

While the concessionaire must pay state and federal taxes on oil and gas activities, the federal taxes are not contingent on the location of the subsoil plot. The State Tax (ICMS) is levied against sales, and the rate varies based on the state in which the field is located. The Federal Tax is actually comprised of two taxes (PIS and COFINS) and is levied against gross revenue. Also, profits are subject to Income Tax and Social Contribution on Profits. Additionally, the concessionaire is required to pay royalties from oil and gas produced, a "special participation," and a "signature bonus."

Required under Article 45 of the Petroleum Law, the royalties that a concessionaire is responsible for consist of 10% of the field's monthly production. The Petroleum Law grants the Brazilian National Petroleum Agency (ANP) the authority to reduce royalties to a rate of 5% if justified by factors such as geological risk.

Field production, for the purposes of determining the amount of royalties to be paid, is calculated by multiplying the volumes of gas and oil produced in a month by their prices (published by the AP in the Official Gazette), respectively.

Thus:

$$\text{Amount of Production} = (V_{\text{oil}} \times PR_{\text{oil}}) + (V_{\text{natural gas}} \times PR_{\text{natural gas}}),$$

where:

V_{oil} is the volume of the field's monthly oil production, in cubic meters;

$V_{\text{natural gas}}$ is the volume of the field's monthly natural gas production, in cubic meters;

PR_{oil} is the price of oil produced in the related month, in R\$/cubic meter;

$PR_{\text{natural gas}}$ is the price of natural gas produced in the related month, in R\$/cubic meter.

Article 45 also requires the concessionaire to pay a "special participation." Further regulated under Articles 21 and 22 of Federal Decree No. 2,705 (August 3, 1998), special participation refers to an extraordinary financial compensation that shall be paid by the concessionaire to the federal government, if the oil field reaches exceptional profitability. Special participation shall be paid from the first quarter in which the production increment occurred. The amount to be paid shall be calculated by application of progressive rates to the net revenue obtained from the field's quarterly production. For these purposes, net revenue is the gross revenue from each field's quarterly production, deducted from royalties paid, investments in exploration, operational costs, and depreciation and taxes provided under Brazilian law.

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Volume of Supervised Quarterly Production (Thousands of m ³ of oil)	Amount to be Deducted From the Quarterly Net Revenue (Reais)	Special Participation Rates (%)
Under 900	-	Exempt
900 to 1,350	900 x (RLP/VPF)	10
1,350 to 1,800	1,125 x (RLP/VPF)	20
1,800 to 2,250	1,350 x (RLP/VPF)	30
2,250 to 2,700	(517.6/0.35) x (RLP/VPF)	35
Over 2,700	1,631.25 x (RLP/VPF)	40

Brazil E&P Sector

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The chart above presents special participation rates, in the first year, for oil and gas extracted in a concession area within the Brazilian continental shelf, at a depth of 400m or less.

Where:

RLP is net revenue from each field's quarterly production;

VPF is the volume of each field's quarterly production.

Additional information on special participation progressive rates may be found in Article 22 of Decree 2,705.

A "signature bonus" refers to the amount paid for the concession of an area. Articles 9 and 10 of Decree 2,705 require that the bonus be paid in one installment, upon signature of the concession contract. The amount to be paid may not fall below the minimum price set by ANP, which has the sole discretion to fix the price of each area offered for concession, based on technical

studies and analysis. ANP is accorded a measure of autonomy under the "best judgment" rule, which asserts that no specific provisions exist limiting ANP's price-fixing capacity.

Being aware of the costs and tax implications of acquiring and maintaining a concession is tantamount in importance to utilizing the concession. We believe that being informed about these issues is the key to ensuring the successful development of concessions.

Keeping up to date is just as important. This is an area where the law and its application change frequently, and where there are many detailed rules, far beyond the scope of this article.

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lems may arise whose political motivation is undeniable. One directly affecting the 6th Round is mentioned as an example: The National Oil Agency (ANP), had announced that it would include among the offered blocks some of the most promising areas that had been included in the Zero Round. Shortly afterwards, however, it was announced that these blocks would be withdrawn, and the Blue Blocks would not be offered in the 6th Round.

Foreign investors are prepared to run the geological risks, but not the regulatory risks.

The foreign investors are prepared to run the geological risks, but not the regulatory risks. In this regard, one upsetting factor arises from the government's statement that it was dissatisfied with the "excess autonomy" of the regulating agencies (including ANP), which had been granted through legislation approved under the Cardoso government. Consequently, the

new government sent a draft bill to Congress for limiting the scope of action of these agencies, whose assignments it wants to transfer mostly to the Ministry of the area (in the case of ANP, to the Ministry of Mines and Energy).

Economic agents view that bill¹ with suspicion, because it indicates that the rules of the sector may be more easily broken. The bill would be enough to change the Minister, an employee in the confidence of the President of the Republic and freely appointed by him.

Consequently, most analysts feel that the agencies will lose their ability to maintain stability in the rules, which is very important when handling economic sectors involving operations whose cycle is reasonably long. Furthermore, oil exploration must have continuity, to permit better knowledge of geological structures.

Under the present government of Luiz Inácio da Silva, a disturbing example emerged in the telecommunications sector. In view of the concession contract terms, the regulating agency (Anatel) authorized a tariff increase. The Minister of the sector at that time did not agree with the agency's authorization and expressed his opinion publicly, giving rise to a wide-

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spread debate. In fact, the Minister suggested through the press that persons affected by the increase should go to Court, to contest Anatel's authorization. He went further: the Ministry's site on the Internet contained arguments aimed at anyone concerned to be used to fight the increase, which was, by the way, authorized by Anatel to fulfill the concession contract. Also, through political pressure, directors of agencies that had been appointed under the Cardoso administration were forced to resign.

This type of occurrence provokes the belief among investors that the government's strategy for a specific sector can change at the whim of political conveniences. Clearly, the regulatory agencies will lose autonomy because the Minister, who is simply someone chosen by the President, will elaborate the policy for the sector without taking into account the demands of private investors. That policy is subject to change at any moment.

The agencies' loss of autonomy also justifies the fear that the ANP, the Presidency (Civil Household) and Petrobras, with its overwhelming influence, could simultaneously formulate the Government's policy.

Similarly, the investors feel keenly the lack of mechanisms for granting financing to small and medium companies, presently available only through the National Economic & Social Development Bank (BNDES) and, specifically regarding gas, the absence of a regulatory framework allowing free access to infrastructure facilities. ANP Ordinance 115/2000 was enacted on July 5, 2000. It provides for free access to pipelines aimed to convey oil and its by-products. In the opinion of many investors, this ordinance does not satisfactorily cater to the matter of free access with regard to gas, although it does so for oil.

Difficulties in the Taxation Regime

In Brazil, both the Federal Government, and the States of the Federation, and, oddly, even Municipalities, have the power to collect taxes, although within limits established by the Constitution.

As these organizations are always seeking new funds, they not only change the tax laws but they also compete amongst each other for tax revenues. Oftentimes, it is forgotten that there is only one taxpayer and it is he who must pay all the taxes and contributions instituted. Without a doubt, it is the unstable taxation regime that most discourages foreign investors in the sector.

The existing concession contracts were hit by unexpected taxation that could not possibly have been part of the calculations made by any entrepreneur at the time of the first bidding rounds. The following paragraphs outline examples of such unexpected taxation.

In 2000, Law No. 10,168, amended by Law No. 10,332, of 2001, created the Economic Area Intervention Contribution (CIDE), which is imposed on payments made abroad for technical services and administrative assistance, widening the scope of this type of contribution. Previously, this tax had only applied to payments of royalties on technology transfers. CIDE is collected by the Federal Government.

Without a doubt, it is the unstable taxation regime that most discourages foreign investors in the sector.

In 2003, Complementary Law No. 116, of July 31, established the imposition of a service tax, to be collected by the Municipalities on services originating from abroad or whose provision began abroad. Many consider this rule to be in conflict with the Federal Constitution, but as far as it is known, this law remains in effect.

Law No. 10,865, of April 30, 2004, effective as of May 1, subjects the entry of foreign goods into Brazil to the federal contributions tax called PIS/COFINS. Imports and exports of equipment used in the prospecting and extraction of oil and natural gas are exempt from these taxes, according to the well-known REPETRO, the rules embodied in Regulatory Instruction No. 4 of January 10, 2001.

However, so-called contributions, such as PIS/COFINS and CIDE, are not considered to be within the scope of the Repetro system. Consequently, companies in the hydrocarbons sector must pay these taxes as well. To aggravate the situation, contribution payments cannot be offset by taxes due in the investors' countries of origin.

As for Repetro, there are still two circumstances that disturb investors. The first is that Regulatory Instruction No. 4 expires in 2007, Although it is too early

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to confirm with certainty whether or not the government will renew this regulation, everything indicates that it will, as it has traditionally done in the past.

More serious and worrying, however, is the attitude of the regulators in the State of Rio de Janeiro. Rio de Janeiro is the site of the Campos Basin, Brazil's principal oil-bearing province, which is currently under exploration.

Law No. 3851 was passed on June 12, 2002, and named the "Valentim Law", after State Deputy Edmilson Valentim, who presented the bill. Through this law, the State decided that the ICMS (the state value-added tax on sales and certain services) would be collected in transactions involving the temporary admission and the importation of goods and provision of services to be used in facilities for producing oil along the coast of the State of Rio de Janeiro. Specifically, the goods and services affected are ones that begin overseas, and then are admitted directly to and through ports of the State of Rio de Janeiro, as well as those goods and services imported through ports of other Brazilian States.

In other words, this law explicitly negates the privileges of the Repetro system, as its Art. 4 explains. Still clearer is the fact that in a recent seminar orga-

As [Articles 157 and 421] are new rules and are full of strong subjectivism, observers fear that the unpredictable judicial interpretations might pose problems for the implementation of economic activities.

nized by the British Chamber of Commerce in Rio de Janeiro, the State Secretary of Finance said that, without exception, "the State of Rio does not accept Repetro." In terms of aggression against what is called the "federative pact," this statement exceeds the most severe initiatives. Instigated by the Brazilian Oil and Gas Institute (IBP), the Attorney General of the Republic filed a Direct Action of Unconstitutionality against that law (ADIN 3171). This case is presently awaiting judgment in Brazil's Federal Supreme Court.

The "Noel Law" (Law No. 4117, of June 27, 2003) has been another law from the State of Rio de Janeiro that has caused concern for oil investors. This law

amended Law No. 2657, of December 26, 1996, and established the imposition of the ICMS on the "oil extraction operation," hitherto free of that tax, defining the taxpayer as "the oil extractor." No one has yet found oil in commercial quantities, but when they do, the state tax collector will already be there.

Evidently, circumstances have not improved after the statement made by the State Secretary of Finance that the State Government is willing to examine the situation on a case-by-case basis and thus possibly heed individual claims. That would be the worst-case scenario for companies attempting to plan medium and long-term investments.

Legal Instability

Concerning stability in the legal framework, other analysts agree that the situation in Brazil became less favorable with the entry into effect of the new Civil Code in January 2003. The new Civil Code then also began to govern business relations, in view of the specific revocation of the old Commercial Code.

Two provisions of the new Civil Code are of particular concern to economic agents in general—both domestic and international. These provisions are Articles 157 and 421.

Article 157 re-introduces into Brazilian Law the concept of "injury," which occurs, according to the legal definition, "when a person, in urgent need, or due to inexperience, undertakes to do something clearly out of proportion to the value of the opposed performance." Article 421 states, "the freedom to contract will be exercised by reason of and within the limits of the social function of the contract".

As these are new rules and are full of strong subjectivism, observers fear that unpredictable judicial interpretations might pose problems for the implementation of economic activities.

Conclusion

Having arrived at this point, the following question arises: Would international oil companies be better off eliminating Brazil from their areas of interest?

Fortunately, this is not the situation, and other schools of thought have reached quite the opposite conclusion.

In early May 2004 there was a meeting in Houston, Texas, of the oil industry, during which a study conducted by *Douglas Westwood* consultants was presented. This study was frankly sympathetic and favorable to Brazil, according to articles in the press.

Without disregarding the abovementioned heavy tax burden and the complaints of companies operating today in Brazil, the study concludes that, in spite of everything, Brazil still offers better prospects than many other regions of the world, including the 50 regions evaluated in the study.

In the opinion of the Douglas Westwood consultants, Brazil compares favorably even with West Africa, one of the regions now in the center of the oil industry's attention.

This conclusion seems to be supported by news that a group of Arab investors, through Arabian Gulf Oil of the Kingdom of Bahrain, is negotiating the construction of a refinery in the State of Espírito Santo. The goal is to turn the region into a processing zone for exporting petroleum by-products.

In view of these differing opinions, we can only trust in the pioneering spirit and in the boldness of the oil investors, with the hope that they will continue collaborating to promote the growth of Brazilian hydrocarbons production.

Endnotes

¹ Bill No. 3337/2004 originating from a draft prepared by the Presidency of the Republic, supported by a Motives Report (E.M.) No. 12, dated April 12, 2004.

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Fitch Gives Petrobras “Stable Outlook” Rating

In a credit update released May 26, 2004, Fitch Ratings services highlighted Brazilian state-oil company, *Petróleos Brasileiros* (Petrobras), as having a stable outlook (B+) rating for its senior unsecured notes and an AAA rating at the national scale.

The report cited Petrobras' credit strengths as being “dominant domestic market position, benefits from market-based reforms, growing upstream volumes and export revenues.” The company's credit concerns include “vulnerability to political interference, exposure to currency risk and commodity cycles, domestic market concentration.”

Specifically, the report notes that the Petrobras management has committed to increasing financial transparency, engaging in corporate restructuring and modernization, and developing upstream production efforts, which should help strengthen the company's credit fundamentals.

Fitch analysts observe that “closer coordination of business plans with federal authorities has not interfered with efforts to improve operational efficiencies, increase upstream production volumes or adhere to capital discipline guidelines.” —J.S.K.

Agency website: <http://www.fitchratings.com>

Petrobras to Engage in Deep Water E&P in Tanzania

On Monday, *Petrobras* announced in a press statement that it had signed an agreement with the Tanzanian government and its state-owned oil company, *Tanzania Petroleum Deveopment Corporation* (TPDC), on June 5th to participate in the exploration of oil in Block 5 of the Mafia Bay. Petrobras obtained the Production Sharing Agreement for Block 5 through Tanzania's first bidding round in 2001.

The Block 5 agreement includes a four-year initial exploration period, and the option to extend the exploration period for another four years, and an additional three years after that. During each of these exploration periods, Petrobras will be obligated to drill at one exploration well. The expiration dates of these periods can be shifted earlier if Petrobras finds exploration conditions in the block to be favorable.

Petrobras' pursuit of exploration activities in offshore Tanzania is part of the company's strategic plan to expand its international operations in deep and ultra-deep water exploration. On the African continent, Petrobras also engages in E&P activities in Nigeria and Angola. —J.S.K.

Company website: <http://www.petrobras.com.br>

Upstream Developments

Singapore SembCorp Marine Gets US\$628M Letter of Intent

BY KEVIN LIM

SINGAPORE (Dow Jones)—*SembCorp Marine Ltd.* (S51.SG) Monday said its wholly owned unit *Jurong Shipyard* has secured a letter of intent to convert a giant tanker into a floating oil production and storage facility for US\$628 million.

The Singapore marine engineering group said *Jurong Shipyard* obtained the letter from *Petrobras Netherlands BV*, a unit of *Petrobras SA*, Brazil's state oil company.

The turnkey contract entails converting the 280,000 dead weight tons very large crude carrier, *Barão De Mauá*, into a floating production storage offloading unit, or FPSO, to be renamed *Petrobras 54*, in 38 months.

Work on the FPSO conversion project is expected to commence in August, *SembCorp Marine* said.

On completion, the P-54 will have full capacity of oil production and treatment at 180,000 barrels a day, gas compression at 6 million cubic meters a day and water injection at 39,000 cubic meters a day, the Singapore company said.

The P-54, which will be installed at water depth of 1,315 meters, is expected to operate for 25 years without any dry docking in the Roncador Field, Campos Basin, offshore Brazil.

SembCorp Marine said the *Petrobras* contract is expected to have a positive contribution to earnings. However, the deal won't materially affect net tangible assets and earnings per share in the financial year ending Dec. 31, 2004.

Petroperú Barred from Privatization; Seeks to Explore

BY REBECCA HOWARD

LIMA (Dow Jones)—Peru's state-owned *Petróleos del Perú S.A.*, or *Petroperú*, cannot be privatized and has been authorized to embark on exploration and exploitation activities, according to a law published last Thursday in the official gazette.

Two weeks ago, Congress voted in favor of excluding *Petroperú* from privatization, marking the second time that the legislative body has passed the bill.

In July last year, President Alejandro Toledo vetoed an earlier congressional bill that excluded *Petroperú* from the government's privatization program.

According to *Petroperú* President Alejandro Narvaez, the exploration and exploitation components are key.

"We could palliate the effects of the current price increase if we had an integrated business. If we had wells that allowed us to obtain crude at the production cost, the impact would be much less on the consumer. We would also contribute more through income tax," he told *RPP* radio Thursday.

Narvaez said that *Petroperú's* first priority is to modernize the Talara refinery located in north-

ern Peru, a project with an estimated \$250 million price tag.

While several of *Petroperú's* assets have already been sold, a group of refineries, including Talara, and a pipeline remain in the government's hands.

Talara supplies about half of Peru's fuel market.

According to the oil official, while the company cannot be sold, there are many financing possibilities for the refinery's upgrade and for future ventures.

"We are in permanent contact with companies in the sector, with investment banks, they are interested in participating through different funding schemes," he said.

Among others he pointed to possible joint ventures and said it was not necessary to modernize the Talara in one phase.

Secondly *Petroperú* will turn to production in order to "ensure our own supply of crude," he said. Finally, it will focus on exploration.

Peru is a net importer of hydrocarbons due to a steadily dwindling oil production.

In May, Peru produced an average of 83,533 barrels of oil a day, for a total of 2,589,523 barrels.

Argentina Petrobras Energia to Study Offshore Oil Sites

BY WAILIN WONG

BUENOS AIRES (Dow Jones)—Argentine oil and gas company *Petrobras Energia* (PECO.BA) has asked the Energy Secretariat for permission to conduct seismic and geological studies in preparation for potential offshore oil exploration projects.

Alberto Da Fonseca Guimaraes, Petrobras Energia's general executive director and country manager, mentioned the exploration plans Monday during an event to launch the sale of a new premium fuel called Podium. The two blocks under consideration, which each measure 10,000 square kilometers in area and 3,000 meters in depth, are located 150 kilometers off the Argentine coast between the Buenos Aires province cities of Mar del Plata and Bahia Blanca.

"This deals with the most expensive and risky initiatives, but to develop new frontiers in the ocean will be without a doubt one of the biggest chal-

lenges for Argentina," Da Fonseca Guimaraes was quoted as saying in local business daily *El Cronista*. The Petrobras Energia press office confirmed his comments.

The press office declined to name exact figures for the preliminary studies but said the investment is separate from the six-year, \$53.6 billion plan that Petrobras Energia's parent, state-owned Brazilian oil group *Petróleo Brasileiro* (PBR), or Petrobras, unveiled in May.

Offshore oil exploration is one of the many goals of Argentina's newly created state-run energy company, Enarsa, which was launched last month as part of the government's wider plan to resolve natural gas and power shortages in the country. But Petrobras Energia says Enarsa is not part of this planned exploration project.

PdVSA Ready to Drill Four New Wells at Tomoporo Field

BY PETER MILLARD

CARACAS (Dow Jones)—Venezuelan state oil giant *Petróleos de Venezuela* (PVZ.YY) is preparing to drill four new wells at the Tomoporo oil field in the Lake Maracaibo region, a PdVSA spokesman said Tuesday.

PdVSA is currently struggling to boost oil production to take advantage of high oil prices and meet the country's new OPEC production quota of 2.93 million barrels a day.

Company officials say PdVSA, with several hundred thousand barrels-a-day of spare capacity, can swiftly meet the new quota. Industry specialists say the company is already producing as much as possible and will have to invest in production facilities to increase output.

"The pre-startup began last week," said the spokesman.

PdVSA will drill a fifth well this year in the La Franquera oil field near Tomoporo in western Venezuela, he said.

Tomoporo is currently producing 100,000 b/d, and the company's business plan calls for output of 152,000 b/d by the end of 2005. Tomoporo and La Franquera are two of PdVSA's main oil exploration areas for the next five years. The company also plans to drill exploratory wells at the El Tejero and Cotoperi fields in eastern Venezuela.

PdVSA plans to invest \$26 billion in exploration and production in the next five years. Over the period, PdVSA plans to drill 3,800 new wells, perform workovers on 5,500 wells, and maintain an average of 111 rigs in operation.

Analysts warn that PdVSA's cash flow has been strained by government spending projects, which will make it difficult to meet this year's \$5 billion investment target. The government recently set up a \$2 billion spending fund that will be directly financed with oil revenue.

Bolivian Gas Referendum

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approximately US\$ 3 billion funneled into this sector. It is important to note that prior to its privatization, Bolivia's formerly state-owned oil company (*Yacimientos Petrolíferos Fiscales Bolivianos*—YPFB) had an annual budget of only US\$ 60 million for all of its projects in the entire chain of hydrocarbons activities. One of the main incentives for the flow of capital into the hydrocarbons industry was Hydrocarbons Law No. 1689, which provided clear rules on the rights and obligations of all the actors participating in the hydrocarbons industry. Most importantly, the Hydrocarbons Law provided a transparent framework for YPFB's tax, royalty and patent obligations.

Many Bolivians view the Referendum as a result of the current administration's lack of an energy policy.

In the last couple of years, problems with the privatization movement became apparent. Certain scandals arose from some privatized companies that were mismanaged and essentially insolvent (e.g., the national airline and railroad companies). These occurrences caused an increased public perception (erroneous or not) that 1) the petroleum companies were not firstly complying with the domestic gas supply regulations (hikes in gas prices), 2) most of the profits were leaving the country, and 3) the petroleum companies were not paying enough in taxes, royalty and patents. An overall sense of opposition to the Privatization process started brewing, reaching its peak with the Pacific LNG project. This project originally planned to export natural gas to Mexico and the United States through a port in Chile, a country with which Bolivia has no diplomatic relations, due to Bolivia's loss of its only outlet to the Pacific Ocean during the Pacific War.

As is common knowledge, the above controversy resulted in the resignation of President Gonzalo Sanchez de Lozada, the president who promulgated the Privatization Law during his first presidential term. Last October, Vice President Carlos Mesa was appointed the new president of Bolivia. In his acceptance speech, he stated that one of his administration's main

objectives would be to incorporate a National Referendum for Bolivia's hydrocarbons policy. Through this referendum, all the Bolivians (over 18 years of age) would be able to decide and participate in the formulation of the nation's hydrocarbons policy. The referendum would allow Bolivian society to be the judge of firstly whether Bolivian hydrocarbons would be subject to export, and secondly, if the decision is positive, through which port the exports would be carried out.

Constitutional Aspects

One of the main obstacles faced by President Mesa was that a "Referendum"—as a legal institution—was not part of the political organization of the Bolivian State, as the Bolivian Constitution of 1994 did not allow or provide for this institution. A constitutional principle establishes that, if an institution is not expressly prohibited by law, it is permitted. But, given that a Referendum is an institution that is exclusively contemplated under a direct democracy, the manner in which it is carried out must be contained in the Constitution. In this sense, Bolivia's political organization has been a representative democracy and not a direct democracy that such a Referendum would represent.

The 1994 Bolivian Constitution states that in order to amend or modify the constitution, it is necessary to take at least two political or presidential terms to perfect the amendment. During the first presidential term, the Project of the Amendment of the Constitution would have to be drafted and later approved by the President and Congress. During Jorge Quiroga's presidential term, Congress approved an amendment draft of the constitution. This draft was put forth during the current presidential term, with certain modifications, including Article 4, providing for direct democracy institutions such as the Constituency Assembly, the Citizen Legislative incentive, and the Referendum. These changes to the Bolivian Constitution were approved on February 20, 2004.

Referendum

Based on the new Bolivian Constitution and pursuant to article 4 described above, and given the lack of consensus in Congress, President Carlos Mesa issued Supreme Decree No. 27449 on April 13th, 2004, to carry out the first Referendum on July 18th, 2004. This Supreme Decree provided that in the month of May, the Executive Branch would provide the questions to be included in the Referendum. The following are the

questions that President Mesa has put forth for the upcoming Referendum:

Question No. 1: *Do you agree with abolishing Hydrocarbons Law No. 1689, enacted by Gonzalo Sánchez de Lozada?*

Question No. 2: *Do you agree with the recovery by the Bolivian State of the property of all the hydrocarbons at the “boca de pozo” (wellhead)?*

Question No. 3: *Do you agree with re-establishing Yacimientos Petrolíferos Fiscales Bolivianos (former state company), recovering the state property of the shares of the Bolivians of the capitalized company, in such a manner that would enable it to participate in all parts of the hydrocarbons productive chain?*

Question No. 4: *Do you agree with President Carlos Mesa’s utilization of natural gas as a strategic recourse in order to achieve useful and sovereign access to the Pacific Ocean?*

Question No. 5: *Do you agree that Bolivia should export its gas under a national policy that covers Bolivian gas consumption; encourages industrialization of the gas sector; charges taxes and/or royalties to petroleum companies of up to 50 percent of the value of the produced gas and petroleum; and allocates income from the export and industrialization of gas towards education, roads and employment?*

Explanation and Analysis of the Questions

The following are some of the explanations given by the Government regarding the questions in the Referendum:

Regarding Question No. 1: The government provides that a “new law” is necessary, and not only an amendment without passing judgment on the current law or who issued it. A positive answer would force the passage of a new hydrocarbons law based on the principles that would result from the rest of the questions. A negative answer would mean an amendment based on positive answers to the rest of the questions.

Regarding Question No. 2: If the answer to this question is positive, it would mean that all future agreements entered into by the State, through YPFB, shall explicitly consider all “boca de pozo” hydrocarbons property to be that of the State. YPFB will be

able to transfer the rights to private companies under the terms provided for in “operation” and “joint production” contracts, discarding the existing joint venture agreements. Current agreements can be revised, independently of the results of the Referendum, with the possible resolution, termination or annulment of these agreements. A negative response would require that the new law continue to allow the transferring of the property of the hydrocarbons in the “boca de pozo” to private companies under the joint venture agreements.

Regarding Question No. 3: If the answer is positive, the government will be authorized to create a new YPFB, which would involve the confiscation of the “Bolivians” shares (allocated during the Privatization Process) and their transference back to the new YPFB. If the answer is negative, YPFB will remain as it is presently, as a non-participant in petroleum activities.

Regarding Question No. 4: The question seeks popular approval for the utilization of Bolivia’s natural gas as an economic and strategic recourse to help with the Bolivian foreign policy. The question does not mention any countries or ports in particular. A positive response would mean that President Mesa will feel enough support to seek an outlet to the sea. The consequence of a negative answer would mean that the population wants to disengage the gas-export issue from the ocean-access issue, and therefore the sale of gas would be analyzed exclusively from any other issue.

Regarding Question No. 5: The question means that the export of gas shall be inserted in a national energy policy, that simultaneously sells gas and allows for massive internal consumption, industrialization in the national territory, and a substantial increase in royalties. “Increasing to 50%” means that, pursuant to the draft law, the taxes will be progressively increased to 50% by means of royalties or a combination of royalties and taxes. A negative response would take away the government’s arguments in support of implementing this type of national energy policy.

Opposition and Criticism

Many Bolivians view the Referendum as a result of the current administration’s lack of an energy policy. Therefore, this forum is a means of obtaining peace in the face of the social unrest that the country is currently experiencing. Furthermore, although President Mesa’s original intent for the Referendum was to de-

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Bolivian Gas Referendum

Bolivia Referendum from page 11

termine whether Bolivian gas should be exported and if so, through which port, these two key questions are noticeably absent from the questions proposed by the Executive Branch.

The general criticisms and opposition that exist against the Referendum and the questions it presents primarily stem from Bolivia's population distribution. This has contributed to opposition by the departments that currently are hydrocarbons producers and therefore direct beneficiaries of the petroleum industry (Tarija, Santa Cruz, and Chuquisaca). Bolivians from these areas protest that the referendum is based on one vote per citizen and that more than 50% of the population live in the "Andean" region, comprised by La Paz, Potosí, Sucre, and Oruro.

If international investors believe that a nationalization policy will result in a serious lack of legal warranties for foreign investment, the Referendum could result in...the failure of Bolivia's goal of becoming a key part of South America's energy matrix.

Furthermore, many analysts point out that the questions are biased, based on the manner in which they have been worded. It is a common criticism that, in spite of the percentage of illiteracy and the general ignorance of the current Hydrocarbons Law by the majority of Bolivians, the question utilizes legal terminology that is not understood by the average citizen. Such terms include "abrogación" (repeal) and "boca de pozo" (wellhead). In addition, the questions contain parts to which no Bolivian would conceivably respond with a negative answer. A perfect example is the first question, which expressly names Mr. Gonzalo Sánchez de Lozada as the president that issued the current hydrocarbons law. In this sense, it is questionable whether the people who vote to abolish the current Hydrocarbons Law would do so because they really believe that it is not effective, or if their vote stems from negative feelings against Mr. Sánchez de Lozada.

The general undertone of the remaining questions hints at the nationalization of Bolivia's energy policy. The possibility that the Bolivian government may adopt a nationalization policy has been met with a

swift and hostile response from petroleum companies. These companies have made it clear that they will resort to arbitration before the CIAC and other international dispute resolution forums if they see that their current contracts are affected. In this sense, the hydrocarbons draft laws that have been circulated by the executive and legislative branches maintain that a new law arising from the Referendum will not affect existing contracts. Yet, the possibility still exists, as presented in the explanations given by the government described above.

Concerning the re-establishment of YPF, many of the skeptics base their argument on the history of politics, bureaucracy, and ineffective administration that plagued the company before its privatization. Furthermore, in order to reorganize YPF, Bolivian shares in privatized companies (e.g., *Empresa Petrolera Andina S.A.*, *Empresa Petrolera Chaco S.A.*, and *Transredes S.A.*, which are currently being administrated by pension funds (AFP's)), as well as the profits from these shares (used to pay retirement benefits) must be transferred to YPF as its capital for entering into business ventures.

Regarding the relation that President Mesa has created between the sale of gas and the procurement of a Bolivian outlet to the ocean, many critics point out that Bolivia currently has a treaty for the use of the Port of Ilo in Peru. Unfortunately, the use of this port has not been developed so far, and it is doubtful whether, even if Chile acquiesces a sovereign outlet to the Pacific Ocean to Bolivia, Bolivia would be capable of developing and effectively utilizing this advantage. Furthermore, it is important to note that Bolivia already has a customs Bolivian territory within the port of Arica, Chile, which is under Bolivian customs control. This outlet is also under-utilized.

Conclusion

Considering that this is a historical moment in which the Bolivian society will directly participate in developing a national policy, it is uncertain what the results of the Referendum will be. Furthermore, it is also uncertain how the answers will be translated into laws and other regulations, nor is it clear whether these changes will be for the benefit and improvement of Bolivia's current economic situation, or as some fear, if such changes will result in the same ineffective system that existed before the Privatization process. Additionally, one of the main concerns from analysts is the consequence that a nationalization policy could have on incentives for providers of foreign direct capi-

tal. If international investors believe that a nationalization policy will result in a serious lack of legal warranties for foreign investment, the Referendum could result in not only the failure of Bolivia's goal of becoming a key part of South America's energy matrix. It could very well hinder the development of Bolivia's entire economy.

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Argentina TGS, TGN Launch Gas Pipeline Bid

BY LAURENCE NORMAN

BUENOS AIRES (Dow Jones)—Argentina's two main gas transporters launched the tender process Friday for the construction of 800 kilometers worth of new pipelines, a series of projects which will add 6 million cubic meters daily to the country's transport capacity by July 2005.

The pipelines will cost \$400 million and will be paid for mainly by Argentina's two gas transporters, *Transportadora de Gas del Sur SA* (TGS) and *Transportadora de Gas del Norte SA* (TGNO2.BA).

Cabinet Chief Alberto Fernandez said authorities are talking with producers to ensure there are producers to supply the extra gas in 2005 and that there are companies to buy it.

Fernandez said that while most of the money for the projects will come from the private sector, there will also be financial support from a government managed energy trust fund.

The move is the latest attempt to deal with an energy crisis that threatens major gas and power shortages in coming years. There are already widespread energy shortages and the problems are likely to get worse in 2005 and 2006 unless gas companies sharply lift investment levels.

An increase in gas transport capacity of 6 million cubic meters daily represents a 5% hike in Argentina's gas transport network of 120 million cubic meters daily. This year, it was estimated that demand will exceed transport capacity by at least 7.5 million cubic meters before the government imposed an energy conservation plan.

The investments involve the construction of a 500 kilometers pipeline for TGS, which will run through seven provinces from the southern Santa Cruz province to Buenos Aires.

TGS Chief Executive Officer Eduardo Ojea Quintana said the pipeline construction will provide

some 2,000 direct jobs and create extra work for 6,000 others. The pipeline will add transport capacity of 3 million cubic meters daily and will cost around ARS675 million (\$1=ARS2.965).

In addition, TGN will pay for the construction of 300 kilometers of pipelines, three new gas compression plants and work to expand production at four existing compression plants. The new pipelines will add 1.8 million cubic meters daily in Argentina's north and 1 million cubic meters daily to transport capacity in western Argentina. The pipelines will cost some ARS500 million to build.

TGN CEO Roberto Phillips said that among the provinces that will be connected to the new pipelines are Salta and Tucuman. These are among the regions which are having to pay for imported gas from Bolivia in order to meet this year's soaring energy demand.

The investment announcement comes at a good time for the companies as well as for Argentine authorities.

President Nestor Kirchner has been highly critical of local gas companies, saying the energy crisis is a result of their failure to invest going back many years. The companies dispute that and say investments only fell after the government froze rates in early 2002.

Nonetheless, with energy companies in the thick of contract renegotiations with the government, it was a good chance for Argentina's two main transport firms to show they were doing what they could to deal with the energy crisis.

Last month, Argentina announced it would spend over ARS11 billion by 2009 on investment projects in order to expand the country's energy infrastructure. Some of these investments will be managed or carried out by ENARSA, the recently created state-run energy company.

Peru Government Says Camisea Gas to Arrive on Schedule

BY REBECCA HOWARD

LIMA (Dow Jones)—Natural gas from the Camisea project will arrive in Lima as scheduled on Aug. 9, a government official said last Tuesday, downplaying the possibility that protests in the area near the pipeline could hold up the project.

"We do not think there is any risk at all," Luis Ortigas, who oversees the \$1.6 billion Camisea natural gas project for the government, told *Dow Jones Newswires*.

In a letter to the Ministry of Energy and Mines, the private-sector *Transportadora de Gas del Perú*, or TGP, the consortium responsible for the downstream phase of the project, warned of possible conflict in the department of Cuzco and called on the government to guarantee the project, according to *Gestión* newspaper on last Tuesday.

The Camisea gas fields are located in the department of Cuzco southeast of Lima and the natural gas and liquefied gas pipelines cross the department before heading west to the capital.

Ortigas said that the Ministry of Energy and Mines has called on the Ministry of Interior to step up security in the area, in response to the letter.

Moreover, "the project is finished. Tests are being run and everything is ready. We do not see any hold up," said the official.

According to Ortigas, area residents in Cuzco, in the province of La Convención, are demanding that TGP pay them a \$20 million compensation for environmental damage.

"TGP is rightly refusing to pay," said Ortigas.

According to the official, the company is responsible for addressing any environmental impact through reforestation and other projects and is in the process of doing so.

Ortigas was harshly critical of the regional president of Cuzco who has reportedly thrown his support behind the population that is planning to launch protests as of June 12, according to *Gestión* newspaper.

"They do not realize that they are the ones who will be harmed if anything happens. They are the main beneficiaries of this project," he said.

According to Ortigas, the Cuzco region will receive 50% of the royalties and 50% of the income tax generated by the Camisea gas project.

In a press release last Monday, Deputy Energy Minister Juan Miguel Cayo also denied any possible delay in the project.

"I do not think it would be possible to delay the arrival of the gas due to a strike as the pipeline is complete," he said.

The Camisea project has become the flagship of the President Alejandro Toledo government, which expects it to help bolster Peru's economy.

Moreover, an export project is also underway that will reportedly convert Peru into a net exporter of hydrocarbons by 2008.

The Peruvian government has estimated that the Camisea project has proven gas reserves of 13 trillion cubic feet and associated liquids of about 600 million barrels.

GE Energy Awarded Gas Pipeline Project in Mexico

In a press release posted on its company website, *General Electric Energy* announced that it has received a 6-year contract to provide maintenance and inspection services for Mexico's new San Fernando Pipeline and two new compression units located in Los Indios and El Caracol.

The 36-inch, 120km natural gas pipeline is owned by *Gasoductos de Tamaulipas*, a special purpose company formed by *Pemex Gas y Petroquímica Básica* and *El Paso Energy*.

The pipeline, constructed by *Techint Mexico*, will carry natural gas between Los Indios and San Fernando, both located in Mexico's northeastern state of Tamaulipas.

The pipeline connects existing Pemex pipeline assets in the region, and will carry 1 Bcf/d, significantly increasing Mexico's gas transportation capacity. Initially, the pipeline will carry gas from the U.S., but eventually, it will transport gas from onshore gas fields in the Burgos Basin. —J.S.K.

Company website: <http://www.gepower.com>

Venezuela Eyes Refineries in Cuba, Caribbean

BY PETER MILLARD

BEIRUT (Dow Jones)—Venezuela may expand its international refining network to include the dormant Cienfuegos refinery in Cuba as well as new refineries in Jamaica and Trinidad and Tobago, Venezuelan Oil Minister Rafael Ramirez said last Thursday.

“That has always been attractive to us,” Ramirez said when asked if Venezuela would go ahead with plans to invest in the Cienfuegos refinery.

Venezuela has discussed reviving the refinery with Cuban officials since 1999, when President Hugo Chavez came into office. Chavez, a fiery populist, is a strong ally of Cuba’s Fidel Castro. Venezuelan officials have said the refinery could run as much as 70,000 barrels a day if it is refurbished.

The investment would form part of a larger plan to expand Venezuela’s refining presence in the Caribbean, which could include new refineries in Jamaica and Trinidad and Tobago, said Ramirez, speaking to reporters on the sidelines of an OPEC meeting.

“We are working on all these deals,” said Ramirez, adding that he will hold an event in Caracas this year to explore the investment options.

Venezuela is the world’s fifth largest oil exporter and has a massive national and international refining network with refineries in the U.S., Europe, and the Caribbean.

State-owned *Petróleos de Venezuela* (PVZ.YY), however, has struggled with its domestic refineries ever since a two-month general strike that ended in February 2003 crippled the oil industry.

Petrobras Marlim Sul Unit Becomes Operational

In a company statement, *Petrobras* announced on Monday that its “FPSO Marlim Sul” production unit started operations in the Campos Bay, located in the coastal region of Rio de Janeiro. The unit is capable of processing 100,000 barrels per day of petroleum, storage of 1.6 million barrels, compression of 2.3 million m³ of gas per day, and injection of 125,000 barrels of water per day.

The start-up of this unit’s operations advances Brazil’s Marlim Sul project, which involves 5 oil production wells, 4 water injection wells, submarine collecting ducts, gas drainage, and a platform. Petrobras expects this system to reach peak production in the second half of this year. —J.S.K.

Company website: <http://www.petrobras.com.br>

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Shell to Exit Brazil's Fuel Distribution Market

BY ADRIANA BRASILEIRO

RIO DE JANEIRO (Dow Jones)—*Royal Dutch/Shell Group* (RD) is planning to exit Brazil's fuel distribution market, local daily *O Globo* said Sunday.

The report said Shell could sell its 2,000 service stations in Brazil to *Petróleo Brasileiro S.A.* (PBR), Brazil's federally-owned oil group.

A Royal Dutch Shell spokesman said there are no such negotiations.

Last week, *Jornal do Brasil*, another local daily, said Shell was reviewing its portfolio in Brazil and that it would cut investments in 2004. Quoting Shell's Brazilian exploration and production VP John Haney, the report said results from recent E&P investments in Brazil have been below expectations, and the company would focus on its operations in Nigeria and the Gulf of Mexico.

PdVSA Guarantees Domestic Fuel Supply

In a statement released Friday, the president of Venezuela's *PdVSA*, Alí Rodríguez Araque, stated that fuel supply in the nation is guaranteed, and that steps have been taken to resolve the supply problems experienced at some Caracas service stations.

Rodríguez said that last Monday, there were some difficulties reported at the Guatire filling plant, which caused a delay in transporting fuel to 25 stations that operate in Caracas.

The *PdVSA* president stated that the company, along with the Ministry of Energy and Mines, drew upon a contingency plan that has allowed fuel supplies to normalize.

According to Rodríguez, the Venezuela's refineries produce about 1.1 million barrels per day, providing sufficient fuel inventory levels. In addition, he stated that the country's 20 distribution plants are operating normally, and that Venezuela will continue the usual fuel exports to the international market.

Rodríguez also assured Caracas residents that the Carenero and Guatire plants, which supply the capital city, have sufficient levels of fuel inventory, and he urged consumers to avoid panicked purchases of fuel. —J.S.K.

Company website: <http://www.pdvs.com>

Argentina Petrobras Energia Starts Premium Fuel Sales

BY LAURENCE NORMAN

BUENOS AIRES (Dow Jones)—The Argentine unit of Brazilian oil giant *Petróleo Brasileiro S.A.* (PBR) has launched the sale of a new premium fuel, the company said in a press statement Monday.

The fuel will be called *Podium* and will allow *Petrobras Energia S.A.* (PC.BA) to compete in the more lucrative high-octane sector of Argentina's struggling fuel market.

A press statement cited *Petrobras Energia's* Country Manager Alberto Da Fonseca Guimares saying "this launch, together with the inauguration of the most modern service stations ... is undeniable proof of *Petrobras's* decision to play an active role in Argentina's growth."

Petrobras will produce the fuel at its San Lorenzo refinery in the western province of Santa Fe. The press statement said *Podium* was jointly developed by Argentina and Brazilian technicians.

The launch of *Podium* allows *Petrobras* to win a piece of Argentina's high value premium market. With most fuel prices frozen under an accord between the government and oil producers, refiners and service stations have not enjoyed the sales' boom that recent high oil prices have created in other parts of the world.

Moreover, in recent years, Argentina's fuel market has shrunk because of the growing number of Argentines who fit their vehicles out with motors that run on cheaper Compressed Natural Gas. Over 20% of the country's car fleet now use CNG.

A report in local newspaper *Infobae* on Monday said that with the launch of *Podium*, *Petrobras Energia* will be competing in the premium category with *Repsol-YPF S.A.* (REP) and the local units of refiners *ExxonMobil Corp.* (XON) and *Shell* (RD).

Repsol dominates the fuel market, producing around half the refined products sold in Argentina.

Brazil's CST May Take Large Stake in Sunoco-Run Coke Plant

BY ANDREA WELSH

SÃO PAULO (Dow Jones)—Brazil's *Companhia Siderúrgica de Tuburão* (CST), the world's biggest exporter of steel slabs, may take a large stake in a 1.6 million ton-per-year coke-making plant to be run by U.S. oil company *Sunoco Inc.* (SUN) in the Brazilian state of Espírito Santo.

Sunoco executives said last month that their *Sun Coke* unit will operate the \$350 million to \$400 million plant, but won't own it as originally planned. Sun Coke owns and operates coking plants, which reduce coking coal to coke which is then used for fuel in the U.S.

Brazilian press said Monday that CST is now planning to take a 58% stake in the new coking plant and use 925,000 tons of the coke produced each year. A CST spokesman acknowledged that talks are underway but declined to comment on the accuracy of numbers that appeared in the press.

The new plant would supply coke to CST's steel operations in Espírito Santo, where capacity is being expanded from 5 million tons per year to 7.5 million tons per year by 2006. CST already uses 100% of the coke it produces at its own 1.7 million ton-per-year local coking plant.

Coke, a slow-burning fuel used in steelmaking operations, has become costly in recent months thanks to booming demand for steel. That has lifted costs for many steel makers in Brazil.

Brazilian press said Monday that local steel makers *Acesita* and *Belgo Mineira* will also take stakes in the new coking plant, as will mining company *Companhia Vale do Rio Doce SA* (RIO), or CVRD, the world's biggest exporter of iron ore.

CVRD shares control of CST with Luxembourg-based *Arcelor* (5786.FR), which is the world's biggest maker of steel. Arcelor also controls *Belgo Mineira* and *Acesita* and has repeatedly said it wants to increase its local steel making activities. Brazil is a relatively low-cost place to make steel because of cheap labor costs and ample supplies of high-quality iron ore.

Arcelor has said it plans to invest \$1.4 billion in its Brazilian steel operations through 2006. The company recently inaugurated a new flat-steel making plant, *Vega do Sul*, in Southern Brazil.

CST's new coking plant, which will use Sunoco technology, is expected to start construction in July and come online in 2006.

Transpetro to Invest \$200M in Ethanol Projects

BY ADRIANA BRASILEIRO

SÃO PAULO (Dow Jones)—Brazil's oil group *Petróleo Brasileiro SA* (PBR), through its logistics unit *Transpetro*, is planning to invest \$200 million over the next four years to expand pipelines that transport ethanol.

A spokeswoman at Transpetro said last Thursday the investment has been earmarked to build about 790 kilometers of pipelines and build the necessary infrastructure to take ethanol from a refinery in São Paulo state to Petrobras terminals on the coast of Rio de Janeiro.

The new infrastructure is expected to boost ethanol transport capacity to 4 billion liters per year from the current 1.5 billion liters per year, Transpetro said.

Petrobras is seeking private partners for the venture, which will complement investments in ethanol transport systems that are already being carried out by the federally owned group.

Brazil is among the world's top ethanol producers. Local fuel distributors blend anhydrous ethanol with gasoline, while hydrous ethanol is used to power specially designed vehicles.

The Brazilian government is working to boost ethanol exports to promising markets such as China and Japan.

Brazil has started talks with China to export the fuel and the technology for producing ethanol-fuelled engines.

The Japanese government has also recently approved legislation allowing anhydrous ethanol to be mixed with its gasoline to meet Kyoto protocol requirements.

Brazil exported 560 million liters of ethanol in 2003. Market players expect exports to jump to 1.5 billion liters in 2004.

Argentina's Energy Crisis May Last Years, Analysts Warn

BY LAURENCE NORMAN

BUENOS AIRES (Dow Jones)—A series of costly emergency measures should allow Argentina to limp through an energy crisis in 2004, but the country faces major gas and power shortages for years to come unless there are significant policy changes.

That was the conclusion of an energy conference held in Buenos Aires on Tuesday, organized by economic think tank *Exante*.

Argentina is already facing its worst energy crisis in years. Gas and power demand has soared since early 2003 thanks to an economic recovery and the government's 2002 decision to convert utility rates from dollars into devalued pesos and freeze them. Power and gas rates fell to a third of 2001 levels.

Argentina would need energy investments of \$3 billion a year to meet future demand. That will require major private sector involvement.

Gas companies say the rate freeze discouraged investment, sparking the shortages. Since thermal production generates over half of Argentina's power, the combination of low water levels and gas shortages also stretched the electricity system to capacity. The government blames companies for the crisis saying they underinvested for years.

President Nestor Kirchner's administration has responded by rationing gas exports and introducing an energy conservation plan based on price incentives. The government is buying fuel from Venezuela, and Argentine companies are importing power from Brazil and gas from Bolivia to meet demand.

Former energy secretary Daniel Montamat predicted these measures would cover half the 15 million cubic meters in daily gas shortages Argentina will likely suffer for 90 days this winter. He said Argentina will spend 2 billion pesos (\$1=ARS2.9625) to import fuel and cover other costs of the crisis and estimated the crisis would shave one percentage point off Gross Domestic Product as a direct cost of lower energy consumption. That's in line with official estimates.

Yet the problems may get worse from 2005.

For the gas sector, there are two issues. One is the lack of exploration investment, which fell to a trickle in 2002. As a result, while output hit a record in 2003 as producers tracked demand, reserves fell to 12 years in 2003, half the amount compared to 1992. Reserves are at a "dangerously low level," Montamat says.

An accord between producers and the government based on some price increases should mean an increase in production. However, investment takes time and output may not grow much until 2006, analysts said.

The gas sector also faces a transport capacity problem. This year, peak winter demand will likely outstrip the 120 million cubic meter in transport capacity by some 7.5 million cubic meters. Montamat says that to return winter gas shortages to the 30-40 days they usually last—instead of this year's estimated 90 days—Argentina must add 5 million-6 million cubic meters of transport capacity every year. That would take investment of \$500 million a year from transporters, a major bet in a country with frozen residential rates, an energy crisis and a history of economic crises, analysts say.

Yet, what most worries analysts is the prospect of a major power crisis. Francisco Mezzadri, regional representative for U.S. company *CMS Energy Corp.*, pointed to 2007 as a crunch year, if demand keeps growing at current rates. The essence of the problem, he explained, is not transmission lines or the gas shortages, which hopefully will be resolved. The danger is that, since the rate freeze, generators have stopped investing in new machines, so Argentina's generation capacity is stuck at slightly over 100,000 Gigawatt hours.

Mezzadri pointed out that a combined cycle unit costs around \$400 million and that it often takes companies four years to go from analyzing an investment to installing the unit. That means generators will struggle to meet demand even if they start investing now.

"If there is a crisis in 2006 or 2007, today we are already too late to do anything about it," he said.

The solution to these problems is investment. Argentina's government recently created a state-run energy company and announced plans for ARS11 billion in investments by 2009. Mezzadri said he does

not know how a government that is struggling to restructure \$100 billion in defaulted debt will find this money.

In any case, Montamat, who served from 1999-2001 under President Fernando De la Rúa, and Mezzadri, agreed that Argentina would need energy investments of \$3 billion a year to meet future demand. That will require major private sector involvement.

Reject Government Attacks

Meanwhile, Alfredo Mirkin, an energy secretary under former president Carlos Menem, provided figures aimed at rebutting government criticisms of energy companies' investment record.

Mirkin said that from 1992-2001, power companies invested \$7.5 billion in infrastructure, including \$3.1 billion in generation. He said these investments produced a 73% rise in installed power capacity, a 50% fall in wholesale prices and 16% decline in clients' gas rates.

"These companies bet heavily on Argentina's future ... and this clearly continued until 2001," CMS's Mezzadri said, adding that power companies' returns

on their investments were far less in Argentina than in other countries.

The analysts gave no equivalent figures for investments by oil and gas companies—the most frequent target of Kirchner's wrath. Nonetheless, private sector officials often note that production of oil and gas has doubled since 1990.

As for solutions, the three analysts agreed: set a path of price increases for all gas and power clients, speed up the renegotiation of contracts with the companies and urgently arrange private, public or mixed financing for half a dozen key energy infrastructure projects.

Above all, said Mirkin, "stop treating the sector as a hostage to politics."

Kirchner's administration say its measures have brought the crisis under control and that service will not be cut to residential or other guaranteed clients. It points out that many of the problems predate this administration and echoes the criticism of many analysts that previous administrations were lax in regulating the energy sector.

Four Companies in Brazil Win Tender to Sell Power to Argentina

BY ADRIANA BRASILEIRO

RIO DE JANEIRO (Dow Jones)—Four Brazilian power companies have won the tender to supply 500 megawatts to Argentina's grid and wholesale market operator, or *Cammesa*, for six months, a spokesman at Brazil's Mines and Energy Ministry said on May 27.

Brazilian power companies *Tractebel Energía* (TBLE6.BR), *Companhia Hidro Elétrica do São Francisco*, or *Chesf*, *Furnas Centrais Elétricas*, and *Cachoeira Dourada* won the tender because they offered the lowest fees. A total of 12 companies bid in the tender.

Tractebel Energía S.A., controlled by *Tractebel Société Anonyme*, a division of *Suez* (SZE), will sell electricity between June and August at \$9.40/MWh for hydroelectric power and \$10.40/MWh for thermoelectric power.

Chesf, a unit of Brazil's federal electricity holding *Centrais Elétricas Brasileiras* (ELET6.BR), will sell hydro power at \$15.80/MWh from September to November. For the same period, sister company *Furnas* teamed up with *Cachoeira Dourada*, a unit of Chilean power company *Empresa Nacional de Electricidad S.A.* (EOC), or *Endesa Chile*, to sell thermo power at \$18.50/MWh.

The prices include transmission fees, but don't represent the final prices at which *Cammesa* will sell electricity in Argentina.

Electricity will be transmitted through *Companhia de Interconexão Energética*, or *Cien*, which is controlled by *Endesa* and controls the transmission lines linking Brazil and Argentina.

Iberdrola Starts Up First Combined Cycle Plant in Brazil

BY ANA CAMPOY

MADRID (Dow Jones)—Electricity company *Iberdrola S.A.* (IBE.MC) said on May 28 that it has started up its first combined-cycle electricity plant in the Brazilian state of Pernambuco.

The plant, which uses gas and water vapor turbines to produce electricity, required a \$330 million investment, the Spanish company said. It will start commercial operations in the coming months.

Iberdrola estimates the plant will produce a yearly 3,975 million kilowatt hours, which will be sold to *Companhia de Electricidade do Estado da Bahia* and *Companhia Energética de Pernambuco*, the company's distributors in Brazil.

The plant is the biggest electricity generator in north and northeastern Brazil with a 520-megawatt installed capacity, the company said. It is located in Puerto de Suape, in the state of Pernambuco.

Iberdrola said it has signed a contract with oil company *Petrobras* to buy natural gas to supply the plant.

By using natural gas as a fuel, combined-cycle plants emit a third of the carbon dioxide produced by a plant fueled by carbon, the company said.

"The installation of combined-cycle power station fits with Iberdrola's aim for cleaner electric generation technologies," the company said in a statement.

The company also added that demand at its three distributors in Brazil has gone up by 4.2% on the year between January and March.

Brazil Grid Operator Dismisses Blackout Risk Through 2008

BY ADRIANA BRASILEIRO

RIO DE JANEIRO (Dow Jones)—Brazil will be able to generate enough electricity to meet the country's needs through 2008, according to the country's system operator ONS.

In a study based on water levels of Brazil's main reservoirs, the government-run agency said there's enough water to guarantee power supply through the end of 2005. It added there's little chance of a blackout through 2008.

Mario Santos, ONS's director, said that estimates for the 2004-2008 period take into account a 5.2% growth in power demand in the next few years and economic growth between 3.5% and 4.0% a year.

"The scenario for power supply is very comfortable going forward," Santos said on a radio interview Monday.

For long-term projections and simulations, the study used water level data from 2001, the worst year since 1930. That year the Brazilian government had to impose a 20% power rationing program because the reservoirs that power Brazil's main hydroelectric plants dropped to critically-low levels.

The agency said abundant rainfall since last year has fattened reservoirs and is responsible for the optimistic forecasts.

Repsol-YPF: No Plans to Increase Gas Natural Stake

BY DAVID ROMAN

MADRID (Dow Jones)—*Repsol-YPF S.A.* (REP), the Spanish-Argentine oil and energy concern, has no plans to increase its stake in *Gas Natural SDG S.A.* (GAS.MC), a company spokesman said Wednesday.

Changes to Spanish takeover laws passed in 2002 allow Repsol to increase its 30.8% stake in the Spanish gas company by 6% without a formal takeover bid.

"Still, there's no plans to do so at the moment, and we're not buying any (Gas Natural) shares in the market," said the spokesman.

The 6% rule is an exception to Spanish law for shareholders that used to own bigger stakes in any company. Repsol owned 47% of Gas Natural, and now

has the option to raise its stake in Gas Natural by 6% every 12 months.

In most cases, any raise in stake over 25% kicks in a mandatory takeover bid.

The spokesman said that any change in shareholding wouldn't imply changes in Gas Natural management, because of agreements signed between both companies.

Both Repsol and Gas Natural, together with utility *Endesa S.A.* (ELE) and water company *Aguas de Barcelona S.A.* (AGS.MC) have been rumored to be in tie-up talks in the last few weeks.

PdVSA Transfers \$750M to Venezuelan Government

BY PETER MILLARD

CARACAS (Dow Jones)—Venezuelan state oil giant *PdVSA* has transferred \$750 million to the government as part of a “development” fund that could reach up to \$2 billion, *PdVSA* President Ali Rodriguez said Monday.

Rodriguez said the transfer was authorized by the central bank’s board of directors, but opposition lawmakers and analysts say it could violate local law.

“This transfer is not illegal, it complies with the requirements of Venezuela’s central bank law,” Rodriguez told the *Venpres* state news agency Monday.

Central bank officials weren’t immediately available for comment.

Opposition lawmakers said they have been left in the dark about the new spending fund and its legal justifications.

“I don’t believe this has any legal explanation,” said opposition lawmaker Elias Mata.

“This merits an explanation before the National Assembly Finance Commission,” added Mata, who sits on the commission.

He said opposition lawmakers were to discuss the issue at a regular meeting on Wednesday, and ask *PdVSA* and government officials to appear in Congress to explain the fund.

Analysts were also quick to question the legality of the development fund.

“The fund may also violate the Central Bank Law, which states that *PdVSA* must sell all receipts from exports of hydrocarbons to the central bank and deposit the respective bolivar amounts in an account at the central bank,” wrote *Credit Suisse First Boston* in a research report Monday.

The administration of President Hugo Chavez has ramped up public spending this year on the back of record oil prices in what analysts describe as an effort to shore up popularity ahead of a presidential recall vote that could take place as early as August.

The Chavez government has been leaning on the central bank to release international reserves for public spending since last year. The central bank refused to decapitalize foreign reserves, but, according to Rodriguez, the bank reached an agreement to have *PdVSA* channel a portion of revenue into the spending fund.

“In general, this is a very positive measure, and I insist, applying correct economic and financial policies, this can be very good for the national economy,” *Venpres* quoted Rodriguez as saying.

The move will limit *PdVSA*’s ability to meet its \$5 billion investment program for this year, and could accelerate inflation as money supply in the domestic financial system increases, said analysts.

PdVSA has been struggling to lift oil production ever since a two-month strike that fizzled in February 2003, brought exports to a halt and caused damage at production facilities.

Venezuela claims that it will swiftly raise oil production to its new OPEC quota of 2.9 million barrels per day, but most oil analysts estimate Venezuelan output at 2.5 to 2.7 million b/d.

“*PdVSA*’s income will fall, casting further doubts on its ability to meet its ambitious \$5 billion investment program,” wrote *Credit Suisse First Boston* in the report.

The bank added that the spending fund will increase money supply in the domestic financial system, thereby increasing the risk of faster inflation.

Venezuela’s foreign reserves reached a historic high of \$24 billion on May 14, and have since declined by \$852 million as of June 4, according to the central bank’s website.

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Pemex Company Developments

Urgent Need for Increased Investment to Reactivate Mexico's Petrochemical Sector

Pemex Gas y Petroquímica Básica (PGPB) director Rafael Beverido Lomelín stated on May 30 that, if the bullish trend for international petrochemical prices persists, the value of Mexico's petrochemical imports will exceed the income generated by the country's crude exports by the end of 2004. Consequently, Lomelín called for the revitalization of Mexico's petrochemical industry through increased investment toward the sector, in order to reduce the country's trade deficit.

Lomelín said that 2004 industrial chemical imports are estimated to total \$15 billion, higher than the \$14 billion in income expected from this year's crude oil sales abroad. Specific measures recommended by the director of PGPB included channeling investments into petrochemical projects (e.g., the Phoenix Project) as a means of strengthening the nation's petrochemical production chain and replacing imports with domestic production.

Lomelín pointed out that, despite the fact that domestic petrochemical demand has outpaced domestic production in recent years, PGPB production increased 3.1% between January and March of 2004, as opposed to the same time period in 2003, with a production level of 1.525 million metric tons.

The PGPB director also provided additional details on the Phoenix Project, which will involve the construction of two petrochemical complexes in partnerships with leading companies—both domestic and international—in the industry.

In April, PGPB received eight concrete proposals from interested investors for the project—three from national companies, and five from multinational corporations. Meetings with these potential investors took place in April and May, where proposals were presented to the selection committee. The selection process will conclude on October 18 with the naming of the chosen partners, and the signing of the Shareholders' Agreement will take place on April 1, 2005.

The first stage of the Phoenix Project will involve the construction of a \$1.8 billion ethylene cracker that will have a production capacity of 1 million metric tons of ethylene and 1.9 million metric tons of derivatives. Lomelín predicts that once this plant enters into operation, it will be able to replace \$2.5 billion-worth of imports each year.

The second project phase involves the construction of an aromatics plant, with a production capacity of 1 million metric tons. The cost of this project is expected to exceed \$800 million, while savings on imports is projected to be approximately \$750 million.

Pemex Strengthens Gas Transport Capacity

In a May 27 company statement, Pemex reported that over the past three years, its PGPB subsidiary has increased its north-south gas transport capacity to 1 Bcf/d.

In addition, PGPB has increased its transport capacity to 2.367 Bcf/d, with interconnections to various pipelines on the U.S. border, of which 1.015 Bcf/d are associated with the *Sistema Nacional de Gasoductos* (National Pipeline System) of the States of Tamaulipas and Nuevo León.

The availability of this pipeline infrastructure is part of PGPB's strategy to increase gas transport capacity in light of the predicted increase in gas production originating from the Burgos basin.

Among the developed projects, the company highlighted the rehabilitation of the *Los Ramones* compression station, to increase transport capacity by 250 Mcf/d, as of October 2001. In addition, the *Cempoala* compression station was upgraded in March 2002, with the intention of guaranteeing natural gas supply originating from northern Mexico towards power stations in the Valley of Mexico, Tula, El Sauz, Salamanca, and el Bajío.

In March 2003, PGPB completed the interconnection with the pipeline network of Texas-based *Kinder Morgan*, allowing a 375 Mcf/d increase in capacity of imported gas to meet the demands of several *Iberdrola* power stations: *Huinalá I*, *Huinalá II*, *Turbogas Huinalá*, and *Monterrey III*. In addition, last August, the interconnection between the transport systems of *Tennessee Gas Pipeline* and *Gasoducto del Río* (of *Electricité de France*) was put into service, supplying natural gas to power generation plants in Río Bravo, Reynosa.

In November 2003, the Natural Gas Transport System of San Fernando, Tamaulipas, also entered into operation, a project executed by *Gasoductos de Tamaulipas S.A.*, an integrated company for which 50% ownership is held by *Pemex Gas y Petroquímica Básica* and the other half by held by *El Paso Energy*. This is the largest project developed in Mexico's natural gas transport sector in the last 23 years, at a cost of \$230

million, and consists of a 36-inch, 114km pipeline that connects the main line of the *Sistema Nacional de Gasoductos* with the Burgos gas processing complex in Reynosa, Tamaulipas.

Pemex Adjusts Domestic Gasoline Prices

As of June, Pemex increased the price of Pemex Premium gasoline by 2.9%, from MXP 7.04 per liter to MXP 7.25. The price on Pemex Magna gasoline also witnessed an increase, albeit a smaller one, of 0.33% up to MXP 6.13 per liter, up two cents from May.

When setting its May prices, Pemex strove to differentiate between these two grades of gasoline by implementing a product quality price differential. Pemex Premium has a lower sulfur content and an octane level of 92, whereas Pemex Magna, an unleaded gasoline, has an octane level of 87.

Currently, due to increased demand for the Premium gasoline grade, the company must import fifty percent of national consumption at international

prices, while the rest of demand is met by output from the National Refining System.

Eighteen percent of total domestic gasoline sales are of Pemex Premium (115,000 b/d), while Pemex Magna makes up the remainder of sales (514,000 b/d).

Pemex Denies Selling Oil at Preferential Prices

In response to public accusations, Pemex stated in a June 3 press release that it does not sell its crude oil at preferential prices to certain countries. The company clarified that the price it sets on its crude exports is determined by supply and demand conditions in the market, using formulas that reflect the daily price maintained by market indicators.

Pemex emphasized that it sells crude oil to refining companies that operate in multiple countries, and that the pricing of crude is completely independent of the adjustment differentials made to domestic gasoline prices. —J.S.K.

Pemex Company website: <http://www.pemex.gob.mx>

Mexico's Pemex Prices \$1.5B Six-Year Bond

BY ANGELA PRUITT

NEW YORK (Dow Jones)—Mexican oil concern *Petróleos Mexicanos* (PEM.YY), or Pemex, priced Tuesday a \$1.5 billion six-year floating-rate note via *HSBC* and *Lehman Brothers* amid strong demand.

The deal, upsized from an initial \$1 billion, was priced at 99.888 and came in 1.32 percentage point over three-month Libor with the coupon set at 1.30 percentage point.

The deal underscored Pemex's strategy of "announcing fewer deals and large benchmarks and trying to reduce the concession between Mexico and Pemex," said Gerardo Mato, head of Latin American debt financing at HSBC, noting the issue was mainly driven by high-quality U.S. accounts.

In a sign of healthy demand, the bonds tightened about four basis points after they were free to trade in the secondary market.

Pemex has said it plans to issue between \$7 billion and \$8 billion in debt in 2004, including \$2 billion to \$2.5 billion in foreign capital markets and \$1.8 billion in bank loans. In addition, Pemex plans capital spending of \$12 billion this year, of which \$11 billion is for upstream activities, including \$1.6 billion in exploration.

While this session saw weaker conditions related to rising U.S. interest rates, Pemex's deal comes after a

period of relative market stability. Emerging market debt has been on a roller coaster ride for weeks as financial markets position for the Federal Reserve to begin raising rates from 46-year lows later this month.

Part of the appeal of Pemex's new deal was that it was a floating-rate security, which is an attractive investment amid times of interest rate uncertainty as the coupon adjusts upward if monetary policy tightens.

"There hasn't been a lot of floating-rate notes issued out of Mexico, Pemex or from emerging market (issuers) in general," said a fund manager. He added that because of the interest rate outlook, "now people are looking at FRNs more closely."

Pemex's offering marks one of few deals that have been placed by major emerging market issuers amid the rate concerns. In late May, South Africa, also investment grade, sold \$1 billion of 10-year securities.

"I think in general Pemex offers good value relative to other Mexican corporated debt, including the sovereign," said Sid Bakst, a senior portfolio manager at *Weiss, Peck & Greer*.

Pemex's last venture overseas was in October when it placed \$500 million in six-year dollar bonds, which had a yield 1.80 percentage points more than the three-month Libor.

Argentina's HPDA Secures Debt Deal; 92% Creditor Approval

BY WAILIN WONG

BUENOS AIRES (Dow Jones)—Argentine generator *Hidroelectrica Piedra del Aguila S.A.* has reached an agreement with its creditors to restructure about \$268 million in debt, the company said Wednesday in a statement to the local stock exchange.

HPDA, which is a unit of French company *Total S.A.* (TOT), said it gathered approval from creditors representing \$246.3 million, or 92% of its debt. The generator has surpassed the two-thirds agreement rate required under Argentine law for this kind of out-of-court debt restructuring, known in Spanish as an APE. HPDA can now submit its proposal for legal approval, which will then make the new repayment terms binding on all creditors.

HPDA is among more than a dozen Argentine energy companies that are cleaning up their debt problems, the result of the country's economic meltdown two years ago and, more specifically, the government's decision to convert all utility rates into devalued pesos and freeze them.

In February 2003, when HPDA launched its offer, the company acknowledged that it would have a difficult time restructuring its debt because of the uncertainty in the sec-

tor. However, because the generator was facing seven bankruptcy petitions against it and would lose its concession if it initiated bankruptcy proceedings, it opted to pursue an APE as soon as possible.

HPDA has now been able to reach an agreement with creditors despite a looming energy crisis in Argentina. However, other energy companies such as natural gas distributor *Metrogas* (MGS) and pipeline operator *Transportadora de Gas del Sur* (TGS) are still struggling with their debt burdens.

HPDA stopped payments on its debt at the end of June 2002 and started talks with creditors in October of that year. After launching its offer in February 2003, it extended the proposal once and modified the terms in April. It then extended the offer once more in late April.

The revised proposal carries three options: a cash option worth 45% of the original nominal value of the old bonds; a bond coming due in 2013 with a fixed interest rate of 4%; and a bond coming due in 2013 with an interest rate that varies according to the company's cash position.

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Best regards,

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