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LATIN AMERICA ADVISOR | Energy

Featured Q&A *with the Energy Board of Advisors*

Q **In announcing a loan to Brazil's Eletrobras last week, the president of the Andean Development Corporation, Enrique Garcia, noted that electricity consumption in Brazil has outpaced economic growth over the past 30 years. What regulatory issues do you see as obstacles to increasing electricity supply? How would you gauge the success of the Lula government's "Luz para Todos" initiative?**

A **Guest Comment: Georges Landau:** "Garcia is right. Demand for electricity in Brazil has increased by an average of over 5 percent per year over the last ten years, and is likely to rise at an equivalent rate over the next decade, outpacing GDP growth. However, investments in power generation have not accompanied this rhythm. One of the great obstacles lies precisely in the fragility of the Brazilian regulatory framework. The government, under Lula, has curtailed the authority, the scope, and, dramatically, the funding of the regulatory agencies—in the case of the power sector, Aneel. There is now in force a complex if controversial model for the electric sector, which has at least the merit of clarity, but the exorbitant rate of taxation for the sector, as well as the low prices for power sold to the government, are dissuasive of new investments. Without them, the country risks new power shortages as soon as 2008, possibly repeating the fiasco of 2001, when electricity was rationed, thereby jeopardizing growth and employment. The administration had planned to auction next December 17 new hydropower concessions (the so-called 'new energy'), but the slowness and ineffectiveness of the environmental licensing process caused the withdrawal from the tender of four of these projects, leading the authorities to reactivate thermoelectric plants, mostly fueled with gas imported from Bolivia at considerable cost. Luz para Todos ('Light for All') is a laudable initiative of the Lula government—bringing electricity to under-privileged rural populations living in remote areas—but, like

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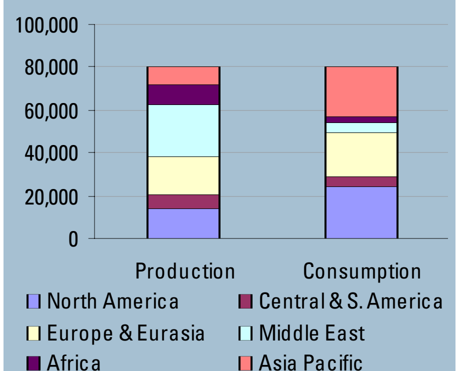
CHART OF THE WEEK

Oil Production & Consumption
2004, by region ('000s bpd),



Source: J.P. Morgan Chase

Inside This Issue

ENERGY SECTOR BRIEFS

Argentine Energy Index Rose 2.4 Percent YoY in September

Argentina's ISE energy production index rose a seasonally adjusted 2.4 percent in September compared to the same month of 2004, the economy ministry said on Friday. Output of "fuel for retropropulsion" led growth in September, expanding 18.2 percent, followed by fuel oil (17.5 percent), liquid petroleum gas (5.8 percent), and electricity (5.8 percent), while the biggest declines were in diesel oil (29.2 percent) and gas oil (11.8 percent).

Source: INDEC.

Ecuador to Freeze Electricity Rates Through April 2006

Electricity rates in Ecuador will be frozen through April 2006, the administration of President Alfredo Palacio announced last Friday. The decision to keep rates frozen came after a meeting between Palacio and representatives of the sector, the president's office said. The government said it would allocate $150 million from the Solidarity Fund to subsidize rates for consumers. It also said a commission was created to study reforms to the country's electricity sector to improve efficiency and reduce blackouts.

Source: Palacio de Candolet.

Venezuela Includes Haiti in Petrocaribe Initiative

Haiti will participate in the Venezuelan-sponsored PetroCaribe initiative, Venezuelan President Hugo Chavez announced Sunday. Under the initiative, Venezuela will cover Haiti's estimated demand of 11,000 barrels per day through generous loan terms. Haiti is the 15th nation to be included in Petrocaribe, which was launched in June.

Source: ABN.

Oil & Gas News

Official: Negligence to Blame for Gas Leak at Dominican Refinery

Poor supervision, a lack of proper equipment and procedures, and negligence led to a gas leak at a state-controlled oil refinery that caused dozens of people in the Dominican capital of Santo Domingo to become ill last Monday and could result in criminal charges, an official said last week according to local daily *Listin Diario*. "There was huge negligence on the part of the technicians at the refinery, although I spoke with the chief of operations and he denied it up until the last minute," Julio Santana, the head of the government's Standards and Quality Control Office (Digenor), was quoted as saying. Santana said those responsible for the leak at the **Dominican Petroleum Refinery** (Refidomsa) of ethyl mercaptan, a strong-smelling and toxic substance that is added to odorless fuel and fuel systems as a warning agent, could be charged for criminal behavior "because we are talking about an issue of national security." He said the government would conduct inspections at Refidomsa and other installations where the substance is used in the wake of the leak. A day after the leak, Dominican President Leonel Fernandez fired the head of the refinery, Aristides Fernandez, who is also reportedly a friend of the president, and replaced him with his energy advisor, Eduardo Rodriguez. Refidomsa is a mixed-capital enterprise in partnership with **Shell International Petroleum Co.** The government's relations with Shell have reportedly grown tense amid differences over operational and financial management of Refidomsa, demands to modify their partnership agreement, and Shell's objections to the government's participation in PetroCaribe, a Venezuelan initiative to finance the sale of oil to Caribbean nations with long-term, low interest loans.

Santana said those responsible for the leak at the Refidomsa could be charged for criminal behavior "because we are talking about an issue of national security."

ExxonMobil Says Restart of Louisiana Refinery "Imminent"

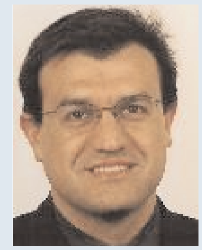
ExxonMobil announced last Thursday that the phased start-up of its joint venture oil refinery in Chalmette, Louisiana is "imminent," according to Reuters. ExxonMobil was forced to close the 190,000 barrels per day (bpd) refinery, which is co-owned by Venezuela's state-owned **PDVSA**, after Hurricane Katrina struck the area in late August, and said in late September that production would restart in November. ExxonMobil brought in temporary housing and other supplies in September to accelerate repair work at the refinery. Despite the interruption in refinery operations caused by Katrina, ExxonMobil—the world's largest publicly traded oil company—reported third-quarter net income of $9.92 billion, versus $5.68 billion for the same three months of 2004, as prices for oil, natural gas, and gasoline hit record highs in the quarter, spurred by demand growth around the world and hurricanes that crimped US supplies. US crude oil futures averaged $63.31 a barrel in the third quarter, up 44 percent from a year earlier. Soaring oil industry profits have provoked criticism from some politicians, who have accused the companies of using hurricanes and other supply disruptions as excuses to raise prices. Speaker of the US House of Representatives Dennis Hastert has urged the industry to invest more in refineries and pipelines to expand supplies and production. In July, ExxonMobil increased its 2005 capital spending plan by 6.3 percent to $17 billion, in an effort to boost oil exploration in Africa, Russia and the

Middle East and compensate for slowing output from wells in North America and Europe.

Board Member Profile

The **Energy Advisor** *is pleased to profile a different member of its Board of Advisors in each issue. Subscribers can pose questions to the Board by contacting Robert Simpson at rsimpson@thedialogue.org.*

Roger Tissot, Director in the Markets & Country Group at PFC Energy



Roger Tissot

Roger Tissot is director in the Markets & Country Group at **PFC Energy**, a strategic advisory firm in global energy.

Prior to joining PFC Energy, Tissot worked with Canadian oil company **EnCana Corp.**, where he developed political risk analysis tools, and analyzed and implemented risk mitigation strategies for corporate projects in Latin America and Africa. Before EnCana, Tissot worked with a number of Canadian-based energy companies on political, economic, and market risk issues in Latin America. He also coordinated the energy component of a Cooperation Program between the governments of Canada and Colombia. Tissot started his career as an energy economist at the Canadian Energy Research Institute (CERI), where he co-authored the studies "Latin American Petroleum Industry" and "South American Natural Gas Market."

Tissot holds an M.A. in Economics from the University of Laval (Quebec) and recently completed his MBA from the University of Calgary.

Power Sector News

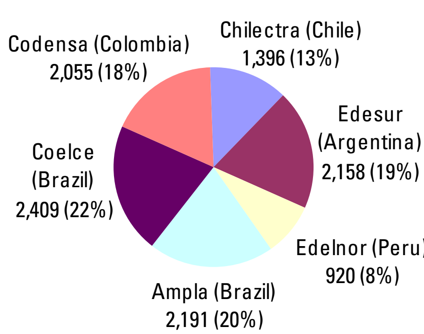
EDP's Brazilian Unit Posts Third-Quarter Profit

Energias do Brasil, the Brazilian affiliate of Portugal's **EDP**, last Wednesday posted a third-quarter net profit after a year-earlier loss as energy prices, power trading volumes, and the number of customers increased. Energias netted 54.6 million reais ($US 24 million) for the July-September period of this year, compared with a net loss of about half a million reais a year earlier, the company said in a statement. EBITDA (earnings before interest, taxes, depreciation and amortization) surged nearly 61 percent to 200.1 million reais, while net revenues rose about 30 percent to 1.1 billion reais. In the first nine months of the year, net profit jumped more than four times from the same period of 2004 to 284.1 million reais. EBITDA rose almost 32 percent to 717.8 million reais, and net revenues increased by 22 percent to 3.3 billion reais in the nine-month period, the company said. Energias distributed 3.1 percent more energy during the nine-month period, which, in addition to an energy tariff increase authorized by the government, helped to boost revenue by 22.1 percent. During the first half of 2005, EDP undertook a corporate restructuring of its Brazilian investments. Energias is made up of now delisted local power distributors **Bandeirante**, **Escelsa**, and **Enersul**, several power plants and projects, as well as energy trading unit **Enertrade**. Enertrade volumes rose 29 percent in the first nine months of the year and about 16 percent in the third quarter. Energias debuted on the **Sao Paulo Stock Exchange** in July following the conclusion of the corporate reorganization.

Chile's Enersis Reports 2.3 Percent Increase in Third-Quarter Net Profit

Chile-based energy company **Enersis** last Thursday reported a 37.251 billion-peso ($US 70 million) third-quarter net profit, up 2.3 percent from the same period of 2004. In a statement, Enersis said its operating profit for the third quarter totaled 576.730 billion pesos, a 12.8 percent rise, driven by growing demand. Enersis' sales grew 5.5 percent, as it gained 304,000 new subscribers since the end of September last year, taking the number of total customers to 11.1 million. Enersis, a subsidiary of Spain's **Endesa**, has power generation, distribution, and transmission operations in Argentina, Brazil, Colombia, Chile and Peru. Enersis said that its overall physical sales volume rose 1 percent in the first nine months of this year compared with the same period last year.

Enersis Customers by Subsidiary
(000s of customers, as of 9/30/05)



Source: Enersis

Cemig's Third-Quarter Net Profit up 18 Percent on Rate Increases

Cia. Energetica de Minas Gerais (Cemig), Brazil's biggest combined power generator and distributor, said third-quarter profit rose 18 percent on increased prices, Bloomberg News reported Tuesday. The Belo Horizonte-based Cemig said net income rose to 445.6 million reais ($US 198 million) from 378 million reais a year earlier. Cemig's earnings benefited from an increase of as much as 24 percent in electricity rates in April from a year earlier and sales that were 3.4 percent higher than the same quarter in 2004, the company said in a statement on its Web site. Net revenue rose to 2.93 billion reais from 2.46 billion reais. Cemig's preferred shares closed up 4.93 percent on Tuesday at 86.05 reais on the **Sao Paulo Stock Exchange**.

Political News

Bolivian Leader Bypasses Congress, Decrees Election for December 18

Bolivian President Eduardo Rodriguez on Tuesday issued a special decree setting December 18 as the new date for general elections, bypassing the country's Congress after lawmakers failed to reach a compromise on a redistribution of seats, local daily *La Razon* reported. After meeting with his cabinet, Rodriguez announced his decision to resort to a decree, a move he called "exceptional." It was the "first and last time" he would use the controversial power, said Rodriguez, who assumed the presidency in June after Carlos Mesa quit amid widespread protests. However, civic and political groups welcomed the decree, saying preserving democracy by ensuring elections was of the greatest importance, according to *La Razon*. Elections were originally scheduled for December 4, but electoral authorities suspended the vote last week after lawmakers failed to strike a deal on a redistribution of seats in Congress in accordance with the most recent national census, as ordered by the country's Constitutional Tribunal in September. The Tribunal ordered Congress to reallocate the seats so that the provinces of Santa Cruz and Cochabamba would receive a combined six extra seats in the lower house, while the provinces of La Paz, Oruro, and Potosi would lose the same number. In his decree, Rodriguez awarded just four seats to Santa Cruz and Cochabamba, and took away four from La Paz, Oruro, and Potosi. Control of Congress is key in Bolivia, since it is the legislative body that decides the presidential election if no candidate wins a majority of the votes, as is expected to happen in the upcoming election. Radical coca farmer Evo Morales of the opposition Movement Toward Socialism leads in polls ahead of the election. Morales, an ally of Venezuelan President Hugo Chavez, supports the full nationalization of Bolivia's vast hydrocarbon resources.

Research Alert

Report: New Investment Key to Hemispheric Energy Outlook

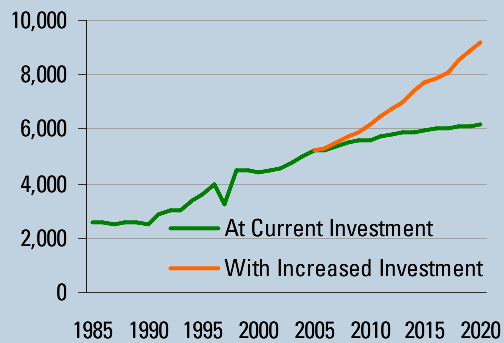
Although total energy consumption is expected to grow in North America and in Latin America and the Caribbean, the Western Hemisphere as a whole will remain a net energy exporter through 2025 if current investment trends continue, according to a new report by the Council of the Americas.

With increased production of natural gas in Trinidad and Tobago and Peru, increased exploration in Colombia and the deep waters of the Gulf of Mexico, and the increased feasibility of unconventional energy sources, including Canadian oil sands, the regional energy surplus could well continue positive growth for the next twenty years, states the report, entitled "Energy in the Americas."

But while advances in exploration and production technologies will allow the Hemisphere's net oil import/export balance to grow from 5.5 million barrels per day (bpd) in 2004 to just over 8 million bpd by 2025, the report says that this surplus is potentially misleading. According to the report, apart from Venezuela, Canada, and to a lesser extent Brazil, countries in the region have not seen any important expansion in their reserve base, and some like Mexico have actually seen a decline in reserves.

In fact, Western Hemisphere net exports will begin to level off in the next five years if current production and reserve levels remain unchanged [see adjacent chart]. However, the Hemisphere has the second-largest global production capability after the Middle East, and with increased investment in exploration and production the region could significantly increase its net export surplus, the report states.

Net Western Hemisphere Oil Exports*
Projected, 1985-2020
(000s barrels per day)



**excluding the United States.*
Source: Council of the Americas.

Featured Q&A
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many other lofty social programs, it is plagued by bureaucratic inefficiency."

A Board Comment: Roger Stark: "The Luz para Todos program is an approximately $1.1 billion program to provide 'universal' access to electricity, create jobs, and improve the standard of living for poor Brazilians. The program addresses the Lula government's goal to provide universal electrical interconnection as an instrument for economic development, and to reduce poverty and hunger. The program is an important step toward shrinking the gap between rich and poor that is a central component of political unrest in Brazil and the region as a whole. Despite the laudable goals of Luz para Todos, Brazil still lacks an integrated regulatory framework to support private foreign investment in the Brazilian electric sector. The Lula government has effectively dismantled the market-based regulatory program implemented under former President Fernando Henrique

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Uribe Warns Paramilitaries to Resume Demobilization

Colombian President Alvaro Uribe on Tuesday warned the country's paramilitary groups to demobilize their forces by year end or be confronted militarily. In a brief statement on the presidential Web site, the Uribe government said there was "no valid reason" for the paramilitary groups to suspend the demobilization. Early last month, Colombia's largest paramilitary group, the United Self-Defense Forces of Colombia (AUC), suspended its demobilization to protest the government's decision to jail an AUC leader wanted in the US on drug trafficking charges. "According to the Santa Fe de Ralito Accord of July 15, 2003, the latest date for demobilization is December 31, 2005," the Colombian government statement said. "Whoever refuses to voluntarily demobilize will be confronted militarily." The US, which Colombia hopes will help fund the demobilization, has supported the government's peace process with the paramilitaries, but at the same time is pressuring the Uribe government to punish those paramilitary leaders accused of drug trafficking, human rights abuses, and other crimes [Editor's note: see related Q&A in the October 12, 2005 issue of the *Latin America Advisor*].

Economic News

Ministry: Mexican Economy Posted 3.5 Percent Growth in Third Quarter

Mexico's economy grew a higher-than-expected 3.5 percent in the third quarter, the finance ministry said Monday in a preliminary estimate, according to Reuters. However, the ministry noted that lost production and working days from Hurricanes Katrina and other storms in September have not been factored into the third quarter estimate. "It is necessary to warn that this forecast is subject to a considerable uncertainty because the impact of weather on the economy in September still cannot be calculated accurately," the ministry said. Analysts also expect a sizeable impact on third-quarter growth from Hurricane Wilma, which devastated the hotel and tourism industry along Mexico's Caribbean coast late last month. **Goldman Sachs** said in a report last week that Mexico would probably lose a quarter of a percentage point in economic growth this year, dropping it to 2.5 percent because of damage caused by Wilma. Mexico's central bank on Monday lowered its forecast for 2005 economic growth for the second time this year to between 2.75 percent and 3.25 percent, down from a previous estimate of between 3.25 percent and 3.75 percent, according to Reuters. The bank cited a slowdown in Mexico's industrial and services sectors. The finance ministry, however, is sticking with its 2005 growth estimate of 3.5 percent. Mexico's economy grew 4.4 percent last year. In the first nine months of this year, Mexico's economy has expanded at an average rate of about 3 percent.

Poll: Brazil's Five-Year Economic Outlook Best in Latin America

Brazil's economic outlook over the next five years is the best in Latin America, 82 percent of European fund managers said in a survey released last Friday by US investment research firm **Morningstar**, according to Reuters. The survey of 43 fund groups managing assets totaling 2.15 trillion euros ($US 2.59 trillion) and conducted October 17-24, found that Brazil accounted for the biggest share of Latin American holdings by asset managers, at 64 percent. Survey respondents said that upcoming elections in the region would likely influence stock market direction, with 78 percent of respondents saying the elections would be important and 14 percent saying they would be "very important." Elections are planned in Bolivia, Chile, and Venezuela in December, while Peru will hold presidential elections in April. Fifty-three percent of fund managers said Latin American economies would be affected by higher US interest rates more adversely than emerging market countries as a whole, according to the survey. In other economic news, Brazil's current account surplus rose 36 percent in September to $2.38 billion from the same month a year ago, the Central Bank said Friday, driven by a 36 percent increase in the country's trade surplus.

POLITICAL & ECONOMIC BRIEFS

Argentine Business Sentiment Has Biggest Monthly Drop Since 2002

Business sentiment in Argentina in September recorded its largest monthly decline since early the height of the country's economic crisis, **J.P. Morgan Chase** said last Wednesday. J.P. Morgan said its index of business sentiment in Argentina, a synthesis of a manager survey done by Argentina's FIEL, fell 1.3 percent last month. "Last month's visible deterioration flashes a yellow light and reinforces J.P. Morgan concerns about medium term prospects,"the firm said in a research note.

Source: J.P. Morgan Chase.

Brazil, Mexico to Reduce Number of Interest Rate-Setting Meetings

The central banks of Brazil and Mexico both said Monday they would reduce the frequency of interest rate-setting meetings, saying economic stability and slowing inflation had made more frequent meetings unnecessary. Brazil's Central Bank said its monetary policy committee, starting next year, would meet eight times a year instead of 12, while Banco de Mexico will reduce the number of rate-setting meetings from 23 to 12.

Source: Bloomberg News.

Officials Deny Cuba Gave Money to Lula Campaign

Brazilian and Cuban officials on Sunday denied allegations, published over the weekend by Brazilian weekly magazine *Veja*, that the Cuban government illegally contributed up to $3 million to the 2002 campaign of Brazilian President Luiz Inacio "Lula" da Silva. Cuba called the report "imperialist" propaganda.

Source: The Miami Herald.

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Cardoso (FHC). Market forces have been de-emphasized in favor of more traditional 'command and control' regulation. These changes, together with shortcomings of the FHC program, have discouraged foreign investment in generation. Many of Brazil's electric distribution companies were privatized during the 90s, and the government has recently implemented a new round of electric transmission concessions. However, the growth of electricity demand continues to exceed the growth in generation capacity, and there is no clear plan for attracting the private capital needed to bridge the gap between projected demand and installed generation. In short, projects like Luz para Todos likely will add to Brazil's sovereign debt load if regulatory reforms to attract private capital are not implemented."

A **Board Comment: Doris Rodriguez & Vera Rechsteiner:** "The market-oriented reforms for the Brazilian energy sector that have been adopted in the wake of the 2001 energy shortages are targeted at attracting additional (and much needed) investment in generation and ensuring adequate supplies to meet projected growth in demand. The model encourages new investment through the competitive bidding of long-term contracts in the RCM (Regulated Contracting Market), aimed at providing investors stable power pricing and facilitating new project financing. In addition, by requiring distribution companies to contract in advance for their power needs in the RCM, the model attempts to achieve a more coherent energy policy, avoiding excess capacity and shortages. An important objective of these reforms is reducing the level of regulatory risk in the Brazilian markets in order to attract new investment in the Brazilian electricity industry. How successful the new model will be in attracting new investment and providing security of supply will depend in great part on how the regulatory agencies implement the market model and on how effectively Brazil's electricity regulatory agency, Aneel, will adopt and enforce enabling regulations for the electricity market. Transition rules to deal with the pricing of so-called 'old energy' (generation capacity of pre-2000 plants) will be important to ensure that projects for new generation capacity are competitive and not subject to delays. Equally important will be the pace of regulatory approval for obtaining new concessions (including the issuance of environmental permits prior to the auctions). A new framework for the key regulatory agencies (including Aneel) is on the list of reforms being proposed by the current administration, although it remains to be seen whether such a reform will be passed by the Brazilian Congress in the current political environment. The current status of the Brazilian public-private partnership initiative (so-called PPPs, whereby large companies are invited to invest in projects with state-backed financial guarantees in return for long-term commitments) is one example of how legislative and regulatory hurdles can affect progress. When Lula's government first floated the idea of PPPs, expectations rose that Brazil's long-standing infrastructure deficiencies would soon be addressed. The Brazilian government's recently announced (and much more modest) PPP scheme is for two pilot projects scheduled to be launched ahead of next year's national elections—none related to the electricity sector. Despite continued investor interest, chronic regulatory uncertainties and delays in launching the scheme (the PPP guarantee fund which is to back the government's obligations is not settled) have contributed to a measure of investor caution."

Georges Landau *is Head of Prismax Consultoria in Brazil.*

Roger Stark *is a member of the* Energy Advisor *board and a Partner Kirkpatrick & Lockhart Nicholson Graham LLP.*

Doris Rodriguez *is a member of the* Advisor *board and a Partner at Andrews Kurth LLP.* **Vera Rechsteiner** *is also a Partner at Andrews Kurth LLP.*

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