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LATIN AMERICA ADVISOR | Energy

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

Q Venezuela last week hailed the return of 32 privately operated oil fields to government control after private oil and gas companies, with the exception of ExxonMobil, agreed by a December 31 deadline to convert their operating contracts into joint ventures with state-run PDVSA. What is the future of private investment in Venezuela's hydrocarbons sector under this new framework? How will the changes affect Venezuelan production?

A Guest Comment: Enrique Sira: "The conversion represents a dramatic change for the private companies operating in the country as well as for the state-owned conglomerate. In the particular case of PDVSA, which has not yet recovered from the dismissal of a significant portion of its labor force, it involves going from a contractor that bore almost no risk and stood to benefit considerably from any upside the fields had to offer to an active partner with all the requirements that such status involves in terms of financial resources, operational and technical know-how, as well as decision-making and planning capabilities. The new position of the state-owned operator is even more challenging as a number of marginal fields that were originally awarded have proven to hold much greater technical challenges than expected. On the other hand, as is common with every challenge, assuming operations of these fields with the original operator as a partner could represent a valuable opportunity for training and technology transfer for the new PDVSA. It remains to be seen if it will be able to reap those benefits, and this will largely depend on how the partnerships are structured. For the investor community, the conversion represents the materialization of the new hydrocarbon law, which states that the private sector can only participate as a minority partner in upstream activities. It also poses a serious question with regards to the gas industry and downstream investments, where the private sector is

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PHOTO OF THE WEEK

Trinidad & Tobago's energy minister, Eric Williams, resigned on Monday after being charged with corruption. See related story on page 2.

Photo: Trinidad & Tobago Ministry of Energy.

Inside This Issue

ENERGY SECTOR BRIEFS

Petrobras Posted Record Refining in 2005

Brazilian state-owned oil company **Petrobras** said Friday it refined a record 1.758 million barrels per day of oil on average in 2005, about 92.4 percent of capacity. The previous record was 1.728 million bpd in 2004. Brazil, a net oil importer, expects to become self-sufficient in oil this year, meeting demand of about 1.85 million bpd on its own.

Source: Petrobras statement.

Rebels Knock Out Power to 400,000 in Colombia

Four hundred thousand people in southwestern Colombia were left without power last week after rebels blew up a key electricity tower, officials said. The attack by the FARC rebels caused blackouts in nine of 13 counties in Putumayo state. Power was not expected to be restored until last Friday at the earliest. Attacks by rebels on energy infrastructure are common in Colombia. Last year, they they blew up 227 electricity towers, up from 121 in 2004 but short of a high of 483 in 2002.

Source: Associated Press.

Profeco: Mexicans Paying Too Much for Gasoline

Mexican consumers are paying an extra 15 percent for gasoline, according to government consumer defense agency Profeco. Agency head Carlos Arce said the extra cost is due to high commissions charged for payments using credit or debit cards, the payment of tips at service stations, and fuel skimming at pumps by service station owners. Some 70 percent of Mexico's service stations are not in compliance with regulations governing gasoline pumps, according to Profeco.

Source: El Universal.

Oil & Gas News

Trinidad & Tobago's Energy Minister Resigns After Arrest on Corruption

Trinidad & Tobago's energy minister resigned Monday after being charged with corruption. Eric Williams, who held the post for three years, appeared in court Monday after police issued an arrest warrant Saturday, according to local newspapers. Prime Minister Patrick Manning accepted the resignation Tuesday and said he would replace Williams soon. Public Administration and Information Minister Lenny Saith has surfaced in local media as a possible replacement for Williams. The Williams warrant was issued in connection with bribery allegations made by businessman and councillor Dansam Dhansook nearly two years ago. Dhansook alleged in a public letter he had paid hundreds of thousands of dollars in bribes to Williams and former Works Minister Franklin Khan in exchange for lucrative seismic contracts for **Terra Seis Trinidad Limited**, the *Trinidad & Tobago Express* reported. Williams has maintained his innocence and is now free on bond. At least three government ministers spoke out in support of Williams, the *Express* reported Tuesday. Junior National Security Minister Fitzgerald Hinds said he had every "confidence in his (Williams') declaration of innocence." Minister of Trade and Industry Dianne Seukeran defended Williams saying his "absence from government will be a loss to the country and to the energy sector of which he is very knowledgeable ... Ultimately the courts will decide." The energy sector contributed approximately 34 percent of Trinidad & Tobago's GDP in 2004, and about 37 percent of government revenues. In 2004, crude oil production averaged 122,902 barrels per day while natural gas production averaged 2.938 million standard cubic feet per day. Trinidad & Tobago has been moving forward aggressively to expand its LNG production, with contracts to supply the US and Spanish markets. Energy companies with business in the country include **BP**, **BHP**, **British Gas**, **Repsol**, **Talisman**, **EOG**, **Venture Production**, **YARA**, **PCS Nitrogen**, and **Methanex**.

Minister of Trade and Industry Dianne Seukeran defended Williams saying his "absence from government will be a loss to the country and to the energy sector of which he is very knowledgeable."

Peru to Start Construction of Gas Liquefaction Plant

Peruvian President Alejandro Toledo on Wednesday will preside over the start of construction of a natural gas liquefaction plant as part of the country's Camisea gas project, local daily *El Comercio* reported. Construction of the $2 billion plant in Pampa Melchorita, some 168 kilometers south of Lima on the Pacific coast, marks the second phase of the project, which aims at exporting $1.5 billion worth of natural gas per year from Peru's Camisea gas fields in a remote area of eastern Peru to the west coast of North America starting in 2009. Delivery of the gas to Lima via pipeline began in August 2004. Construction of the plant is being undertaken by **Peru LNG**, a consortium headed by the US' **Hunt Oil** with the participation of South Korea's **SK Corp.** and Spain's **Repsol**. The project is expected to add one percent of growth per year to Peru's gross domestic product, while the Peruvian government will receive $800 million annually from LNG exports.

Peruvian President Aspirant Humala Proposes Higher Oil Royalties

Left-leaning nationalist Ollanta Humala, a serious contender for Peru's presidency in the country's April elections, last week proposed higher oil royalties, according to

Bloomberg News. "This extra should be benefiting our children in the shape of health and education programs and not the oil company owners in their boardrooms," Humala was quoted as saying. A former army lieutenant colonel who led a failed coup against the government of ex-President Alberto Fujimori in October 2000, Humala is leading in some polls ahead of conservative candidate Lourdes Flores Nano. Humala has said that if elected, he would revise government oil and gas contracts with foreign investors, although he has stopped short of calling for the nationalization of foreign oil firms. In the past month, his popularity in Peru has helped push down local markets. His proposals for Peru's hydrocarbons industry echo similar moves made in Venezuela and Bolivia, where governments are asserting greater control over oil and gas assets. Last week during a visit to Spain, Bolivian President-elect Evo Morales said his government would be "radical" with energy companies conducting illegal operations, according to Bloomberg News. Some oil companies smuggle Bolivian oil and gas into neighboring countries rather than sell in Bolivia where prices are controlled, Morales said. "My government will exercise its property rights over all its natural resources. We will nationalize. This doesn't mean that we will conquer, or expropriate, or expel businesses,'' he told reporters in Madrid. Spain's **Repsol** is the biggest investor in Bolivia with about $1.2 billion assets in the country. In Venezuela, the government has obliged companies to convert operating contracts into joint ventures with state-run **PDVSA** [Editor's note: see related Q&A on page 1].

"This extra should be benefiting our children in the shape of health and education programs and not the oil company owners in their boardrooms."

Photo: Peruvian Nationalist Party

– Ollanta Humala

Featured Q&A
Continued from page 1

still free to participate in any measure. Will the gas industry or downstream activities be next to face increased taxation or government efforts to take it over and assume control?"

A **Board Comment: Luis Giusti:** "The international oil companies operating in Venezuela have contracts that date back to the *Apertura Petrolera* launched in the mid 1990s. Equity deals were signed for integrated extra-heavy oil projects in the Orinoco and for exploration and production profit-sharing projects. Operational agreements were also utilized for old oil fields. These were essentially service contracts, under which the operator charged a fee for delivering the barrels to the national oil company, PDVSA. Because the 'fat' part of the portfolio was reserved for PDVSA, the barrels from those agreements were, by design, the most expensive ones, but still profitable. Being service contracts with no crude entitlement for the operator, the industrial income tax of 34 percent was applicable. But the current government challenged the contracts, demanding a retroactive income tax of 50 percent, typical of equity oil deals. The government also announced that those agreements were to be migrated into equity deals. The premise was that not accepting the migration, or by the same token the tax change, meant having to leave the country. After some 8-10 years in Venezuela and having large sums of sunken capital, the companies had no other option but to renegotiate. The Venezuelan government has the legitimate right to aspire for better terms of association, but that should never come through unilateral changes of contracts or coercion. Added to PDVSA's large loss of its own production capacity, this can only jeopardize even further the possibilities of a significant production expansion."

A **Board Comment: Roger Stark:** "The government of Venezuela (GOV) appears committed to a program of 'creeping expropriation' of foreign oil interests. In 2005, the

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Analyst: Venezuelan Highway Closing Shouldn't Hurt Oil Exports

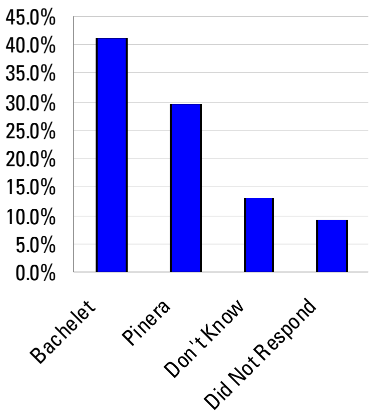
The forced closing last week of a key Venezuelan highway should not affect the country's oil exports, an analyst said in a research note on Friday. However, Manuel Suarez-Mier, head of Latin American economics at **Bank of America**, said the closing of the highway connecting Caracas to the port of Guaira, made necessary after a major bridge threatened to collapse, could affect internal distribution because pipelines attached to the highway had to be shut down. State-owned **Petroleos de Venezuela** (PDVSA) said last Thursday in a press release published on its Web site (www.pdvsa.com.ve) that distribution of fuel to service stations in Vargas state would not be affected by the closing of Caracas-Guaira highway. Fuel would be guaranteed by the Catia La Mar plant, which has enough reserves to supply the market for 34 days and will be resupplied by sea from different refineries throughout the country, PDVSA said. Venezuelan President Hugo Chavez said Sunday that the highway should be reopened in about two months after a temporary access road is completed, according to Bloomberg News. The two-kilometer (1.2 miles) access road will allow drivers to use the highway while a 163 billion bolivar ($76 million) bridge—expected to enter service next year—is constructed, Chavez said. Bank of America's Suarez-Mier said the highway's closing could become "a serious economic problem" for the Venezuelan government.

Political News

Poll: Bachelet Enjoys Wide Lead Over Pinera in Chile

Socialist Michelle Bachelet of the ruling Concertacion coalition has a wide lead

Chilean Presidential Poll



Source: Reuters, La Tercera, *DataVoz.*

over her conservative opponent, Sebastian Pinera, ahead of this Sunday's second-round presidential vote, Reuters reported, citing a poll by **DataVoz** and published Saturday in local newspaper *La Tercera.* According to the poll, Bachelet would win 41 percent of the vote versus 29.7 percent for Pinera. DataVoz said 12.9 percent of voters were undecided and 9.2 percent did not respond. "To reverse this tendency, Pinera would have to capture something in the order of 70 percent of the undecideds and people who did not respond," the polling firm said. Bachelet, a former defense minister, finished first in the first round of the election on December 11 with 45.9 percent, but failed to get the more than 50 percent needed to avoid this Sunday's run-off. If elected, she would be the fourth straight president from the Concertacion since the end of military rule in 1990 and the first woman president of Chile. The DataVoz poll was conducted between December 19 and January 4 and had a margin of error of 2.8 percentage points.

Haiti Sets February 7 as New Date for Elections

Haiti's Provisional Electoral Council on Sunday set February 7 as the new date for presidential and legislative elections, Reuters reported. "For us this schedule is official and final. We discussed it with the government, which has no objection," Rosemond Pradel, secretary general of the Council, was quoted as saying. The elections, which have been delayed several times since November, were supposed to take place January 8, but the Council canceled them last week amid logistical problems, rampant violence, and a wave of kidnappings. The head of the United Nations mission to Haiti, Juan Gabriel Valdes, said the new date was firm. "It will be final and the UN mission is ready to accomplish every task in its competence to make sure the new schedule is met," Valdes stated. If none of the 34 candidates competing in the presidential election win an outright majority on February 7, a run-off vote will take place on March 19 and a vote for local government officials on April 30, Pradel said. The elections would be the impoverished Caribbean nation's first since the ouster of former President Jean-Bertrand Aristide in February 2004 amid an armed rebellion. Since then, the country has been ruled by an interim government. Haitian interim Prime Minister Gerard Latortue said last week he plans to step down as planned next month even though it appears unlikely the country's new leader will be in place before his final day. In related news, commerce came to a halt in Haiti on Monday on the first day of a general strike to protest the kidnapping wave, the Associated Press reported. The strike was called by the Haitian Chamber of Commerce as a means of pressuring UN peacekeeping forces to move more aggressively against gangs believed responsible for the kidnappings. There are some 7,400 UN troops in Haiti to help provide security for the elections. In related news, the military commander of the Brazilian-led UN force in Haiti was found dead Saturday with a pistol shot to the head in what officials said was an apparent suicide, according to Reuters. Brazilian Lt. Gen. Urano Teixeira da Matta Bacellar was found dead in his hotel suite on Saturday dressed in a t-shirt and shorts with his 9mm pistol by his side. "According to the elements we've found, I'm 95 percent sure Gen. Bacellar committed suicide," said an unnamed UN police investigator cited by Reuters.

Mexico, Central America Demand US Permit More Immigration

Mexican and Central American diplomats on Monday demanded guest-worker programs and the legalization of undocumented migrants in the United States, the Associated Press reported. Meeting in Mexico City, the diplomats criticized a US bill tightening border restrictions and making illegal immigration a felony. The officials from Mexico, Nicaragua,

Venezuela Expanding Fuel Assistance Program to Poor in US

The Venezuelan government said Friday it would expand a program to provide cheap heating oil to poor people in the United States.

Venezuela's ambassador to the US, Bernardo Alvarez, said he would sign an agreement this week with the Penobscot, Micmac, Passamaquoddy, and the Houlton Band of Maliseet Indians to provide the cheaper heating oil.

Alvarez
Photo: Venezuelan embassy.

Citgo, the US affiliate of Venezuela's state-owned oil company, **PDVSA**, has already begun selling discounted heating oil to low-income residents in New York City and Boston.

Critics of the two Democratic congressmen who facilitated those deals, Reps. Jose Serrano (NY) and William Delahunt (MA), say they have helped Venezuelan President Hugo Chavez, a fierce critic of the US and the Bush administration, score a propaganda victory.

The two congressmen say they are only doing what they can to help their constituents heat their homes amid high world prices for oil and natural gas.

Source: Associated Press.

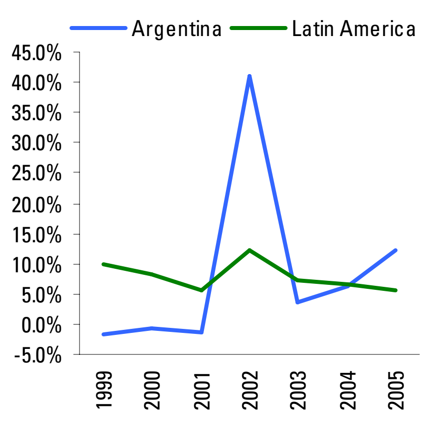
Guatemala, El Salvador, Honduras, Belize, and Panama said migrants should not be treated like criminals regardless of their migratory status, while they vowed to fight migrant trafficking. They announced the creation of a working group to design a regional policy to prevent migrant abuse and to monitor the course of the US legislation. The bill, which calls for construction of 700 miles of fence along the 2,000-mile US-Mexico border and requires employers to verify workers' legal status, was passed in the House of Representatives in December and awaits consideration in the Senate in the next two months. The House bill does not contain provisions for a guest worker program, a component President George W. Bush has encouraged. Mexicans are outraged by the proposal, and Mexican President Vicente Fox has called the bill "shameful." In a Q&A published this week in the daily *Latin America Advisor*, Andrés Rozental, president of the Mexican Council on Foreign Relations and a former Mexican ambassador to the US, said "the mere idea of more fences on the border with Mexico is offensive to those of us who have been working on building a North American Community to make our region more prosperous, secure, and competitive in a globalized world." Rozental and several commentators queried by the *Advisor* expressed doubt the proposed fence would have an impact on what they said is essentially an economic problem. However, one of the House bill's supporters, Rep. Tom Tancredo (R-CO), said the fence would be effective. "We cannot solve the economic problems of Mexico. We are simply dealing with those problems," Tancredo told the *Advisor*. Mexicans living in the US sent home more than $16 billion in remittances in 2004, Mexico's second-largest source of foreign currency after oil exports.

Economic News

Argentina Ends 2005 with 12.2 Percent Inflation

Argentine ended 2005 with consumer price inflation of 12.2 percent, the highest annual rate since 2002, Reuters reported. With the exception of 2002, when inflation hit 41 percent following a steep devaluation of the peso currency, 2005 was the first time annual inflation in Argentina was in the double-digits since 1992, when consumer prices rose 17.5 percent. It was double the annual inflation rate in 2004 of 6.1 percent and surpassed analysts' expectations of a 12 percent increase in consumer prices. The average forecast for 2006 inflation in Argentina by analysts polled in a survey by the *Advisor* last month is 12.6 percent, while growth is predicted to fall to 5.4 percent from about 9.0 percent this year. The government of President Nestor Kirchner has sought to keep a lid on inflation by pressuring supermarkets, food suppliers, and manufacturers to temporarily freeze or reduce prices, and by issuing loans from state-owned banks to stimulate greater production and offset an imbalance in demand. **Credit Suisse First Boston** said in a research note last week that it expected inflation to continue rising in the coming months, albeit gradually. "The Kirchner administration's commitment to a tight fiscal stance together with a less expansionary monetary policy will hold down the pace of inflation in 2006," CSFB said, noting it expected inflation to peak at 14-15 percent in mid to late 2006. In December, consumer prices rose 1.1 percent, the biggest increase for the month since 1990.

Annual Inflation in Argentina and Latin America
1999-2005



Source: CSFB.

POLITICAL & ECONOMIC BRIEFS

Alckmin Declares Candidacy for Brazilian Presidency

Sao Paulo state Governor Geraldo Alckmin on Monday announced his plans to run for president in Brazil's October elections. The announcement by Alckmin, of the opposition PSDB party, puts pressure on Sao Paulo Mayor Jose Serra, also of the PSDB, to declare his candidacy for president. According to recent polls, Serra would defeat current President Luiz Inacio "Lula" da Silva in a second-round vote. He lost to Lula in 2002.

Source: Reuters.

Mexican Inflation Fell to 37-Year Low of 3.33 Percent in 2005

Mexico ended 2005 with annual inflation of 3.33 percent, above the central bank's target of 3 percent but still the lowest rise in consumer prices in 37 years. Inflation was 0.61 percent in December, slightly higher than expected. However, the central bank is expected to continue cutting interest rates to stimulate growth in the country.

Source: Reuters.

Chile 2005 Growth Expected to be at Least 6.0 Percent

Chilean Finance Minister Nicolas Eyzaguirre said the nation's economy closed 2005 at 6 percent growth or more. Chile's economy grew at its fastest pace in five months in November—6.1 percent year-on-year—as prices for copper hit record highs and industrial production expanded more than analysts expected. Lower rates of growth from July to October had led some to believe that 2005 would be a slower year.

Source: Bloomberg News, El Comercio.

Featured Q&A

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GOV imposed substantial (some would say punitive) royalty increases on foreign oil companies operating Venezuelan properties. Although final terms are yet to be negotiated, the GOV is now taking up to a 90 percent stake in the 'joint ventures' created out of formerly private operating concessions—the price (if any) to be paid for such stakes has yet to be determined, but can safely be assumed to be less than the private parties would ask if given the chance. The GOV's actions will be counterproductive in the long run. However, they are neither unprecedented nor even entirely surprising: oil price spikes cause political upheaval, which in turn exacerbates political risk (particularly in statist governments like that of Hugo Chavez). Political risk causes investors to demand 'risk-adjusted' (*i.e.*, above market) returns. So long as oil prices hover at or above $50/barrel, and previously invested capital is 'trapped' (economically, legally, or otherwise), the GOV can finance its share of production activities without the necessity of paying a competitive rate of return to attract new investment. The costs to Venezuela of this approach include a variety of financial and operating inefficiencies, reduced private investment, and the risk that investment capital will be unavailable when needed. Hemispheric costs include an ongoing lack of regional energy integration that reduces fuel diversity and prolongs our dependence on hydrocarbons."

> "The [government of Venezuela's] actions will be counterproductive in the long run. However, they are neither unprecedented nor even entirely surprising"
>
> *– Roger Stark*

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

Report: Ecuador's Budget Tight, Finances Uncertain in 2006

Slower economic growth and lack of access to credit may damage Ecuador's financial stability, **Fitch Ratings** said in a report last week. "Tight liquidity, uncertain financing, and political risk will leave the government with little margin to maneuver to avoid payment irregularities this year," Morgan Harting, Fitch senior director and lead sovereign analyst for Ecuador, said in the report. Harting said Fitch's negative outlook for Ecuador could be maintained through October, when the Andean country holds legislative and presidential elections, "or until prospects for fiscal financing become clearer." The government's spending commitments, which have risen in the past months, will likely continue to increase as elections approach, Fitch said. Boosting access to domestic and foreign private credit will be tough in light of dampened confidence due in part to political unrest. Fitch expects growth in Ecuador to decelerate in 2006 to 3.0 percent from an estimated 3.3 percent last year as a result of lowered investor confidence and inflation, which is of particular concern to Ecuador's global competitiveness since its dollarized economy cannot offset growing inflation through nominal exchange rate adjustments.

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