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

Q Venezuelan President Hugo Chavez confirmed last week that he would keep Rafael Ramirez as energy minister and president of state-owned oil company PDVSA. What is the outlook for Venezuela's oil sector under Ramirez? How will he address what critics say is underinvestment by PDVSA? Does Venezuela have a strategy in the event of a steep fall in oil prices? What's in store for foreign oil companies?

A Board Comment: Luis E. Giusti: "All announcements by the president about Venezuela's oil industry show that he is happy with what they are doing, but there is a wide gap between 'the talk and the walk.' Official information may look reasonable to the layman. Plans to invest $60 billion, including $20 billion from private companies, to increase production to 5.5 million barrels per day (bpd) by 2012, to build four new domestic refineries, to seek a larger penetration into Latin American markets and to increase sales to China, are just a few on their long list. But reality lags far behind. PDVSA's production capacity has fallen by 1.8 million bpd; the build-up by private companies, currently standing at 1.1 million bpd; is stalling as a result of sudden and arbitrary changes of rules, procrastination, and confusion; not a single dollar has been invested in refining; and dozens of MOUs are collecting dust in drawers, while the 2012 target is unviable even under optimal conditions, let alone with a maimed national oil company as is the case of PDVSA today. So we can expect more of the same, *i.e.* Venezuela to remain an important oil producer/exporter, but with no possibility of expanding in line with its very large reserves. This could change for the better only if the government's immense spending starts sputtering, forcing their walk to catch up with their talk by opening new space for investments from international companies. That, however, may be far down the road

Q&A continued on page 6

PHOTOS OF THE WEEK

AES chief executive Paul Hanrahan (left) and company Latin America president Andres Gluski (right) face troubled waters after Venezuelan president Hugo Chavez declared Monday he will nationalize EDC, which AES majority owns. See related story on page 2.

Inside This Issue

ENERGY SECTOR BRIEFS

ICSID to Name Arbitrator for Ecuador in Dispute with Oxy

The World Bank's International Center for Settlement of Investment Disputes (ICSID) will name this week an arbitrator on behalf of Ecuador to a three-member panel in a case brought by US oil company **Occidental Petroleum**, Reuters reported on Tuesday, citing an unnamed member of Ecuador's defense team. Occidental is seeking $1 billion in damages and the return of its assets after the Ecuadorean government canceled its contract with the company in May.

Argentine Govt. Okays Increase in Electricity Rates for Businesses

The Argentine government on Monday authorized power distributors **Edenor** and **Edesur** to raise rates by about 15 percent for industrial and business clients, Reuters reported. The companies have been asking for an increase for years amid a nearly five-year-old freeze on utility tariffs implemented during the country's 2001-2002 economic crisis. Residential consumers will not be affected by the announced rate hike, according to Reuters.

Petrobras Announces Debt Exchange Offer

Brazil's state-owned oil company **Petrobras** announced Friday it plans to offer to exchange up to $500 million in older notes for new debt and cash. In a statement, Petrobras said it wanted to exchange five series of notes for debt maturing in 2016 and paying a coupon of 6.125 percent. The 2016 notes, which were sold last October, would be reopened for the exchange. Terms for the exchange will be established on January 19 and the offer will expire on February 1, Petrobras said.

Power Sector News

Chavez Announces Plan to Nationalize EDC, Other Utilities

On the eve of his inauguration this week to a second six-year term, Venezuelan President Hugo Chavez on Monday announced sweeping plans to establish greater government control over the economy, including the nationalization of telecom and power companies, and a constitutional amendment to strip the Central Bank of its autonomy. "We're moving toward a socialist republic of Venezuela, and that requires a deep reform of our national constitution," Chavez was quoted as saying in a televised address after swearing in his new cabinet, according to the Associated Press. "We're heading toward socialism, and nothing and no one can prevent it."

The fiery Venezuelan leader said he would seek to nationalize **CANTV**, the country's biggest telecommunications company, and while in his call for nationalizing the power sector he did not mention any electric companies by name, he was understood to mean **Electricidad de Caracas**.

> "The nation should recover its ownership of strategic sectors... all of that which was privatized, let it be nationalized."
>
> ***— President Hugo Chavez***

"The nation should recover its ownership of strategic sectors," Chavez said. "All of that which was privatized, let it be nationalized." Chavez also said four multibillion dollar heavy oil projects involving major foreign oil companies "must become property of the nation," although officials later said the president was referring to longstanding plans by the government to gain majority stakes in the ventures, according to Reuters. The Chavez government has already established greater control over the country's oil sector, last year forcing foreign companies to convert operating contracts into joint ventures giving state-owned oil company **PDVSA** majority control.

US officials express concern for investors and economy... US officials said Tuesday that Venezuelan President Hugo Chavez's plans to nationalize power and telecom companies would not benefit the country and said that any US businesses affected would have to be compensated. "The proposals that [Chavez] has made concerning nationalization are a well-worn path that history has shown does not usually benefit the population of the country in question," State Department spokesman Sean McCormack was quoted as saying by Reuters. "At this point, if there is in fact a follow-through on nationalization there is an accepted international practice in foreign companies being compensated at fair-market value for the assets that have been nationalized." Gordon Johndroe, spokesman for the White House National Security Council, criticized Venezuela's nationalization plans, stating "in general these types of actions do not produce economic benefits as expected."

McCormack

File Photo: State Dept.

EDC, Venezuela ratings downgraded... New York-based **Fitch Ratings** said Wednesday it downgraded its ratings for power company Electricidad de Caracas (EDC), the largest privately controlled utility in Venezuela, on expectations that the company was targeted for nationalization. "Should the government of Venezuela move forward to nationalize the targeted sectors, including electricity, the probability of default would be high for EDC," Fitch said in a press release. "In addition, the expected recovery levels for creditors of EDC would be below average, as it remains highly uncertain that the Venezuelan government would use its financial resources to compensate investors of nationalized companies at a fair market value." US power company **AES Corp**. is the majority shareholder in

EDC. EDC transmits, distributes, and markets electricity to the metropolitan Caracas area. In June 2000, AES acquired an 87 percent interest in EDC for $16 billion in a public-tender offer. Venezuela's National Securities Commission suspended trade in shares of EDC Tuesday after a 20 percent drop, and urged investors to keep calm. Shares of AES on the **New York Stock Exchange** fell more than 4 percent on Tuesday. Some analysts note that Chavez would have to proceed cautiously if he goes ahead with the nationalization plans, as the US could retaliate by freezing assets belonging to **Citgo**, the US refining and gasoline distribution arm of Venezuela's state-owned oil company PDVSA. **Standard & Poor's** also downgraded its Venezuelan sovereign ratings on Wednesday [Editor's note: see also "Special Q&A" at right].

Alcoa Signs Agreement to Begin $372 Million Brazil Power Plant

Alcoa announced Thursday that a shareholder agreement was concluded by investors in its Serra do Facao hydroelectric plant, which formalizes the creation of a company to construct a $372 million facility on the Sao Marcos River in central Brazil. The consortium companies funding the project are the Brazilian federal power company **Furnas Centrais Eletricas** (49.5 percent), Alcoa (35 percent), the **Pocos de Caldas Municipal Electricity Department** (10 percent), and construction company **Camargo Correa** (5.5 percent). "The investment is part of Alcoa's long-term strategy of developing energy projects in Latin America to support its smelters and move toward self-sufficiency for its energy needs," the company said in a statement. The consortium will be responsible for managing plant construction and its transmission system, and for implementing social and environmental programs in the surrounding communities. With generation planned to start in 2010, Serra do Facao will produce 210 MW of installed capacity. Construction is scheduled to start in early 2007, with installation of the construction site in the municipalities of Catalao and Davinopolis, in Goias. Elsewhere in Brazil, Alcoa is a shareholder in the hydroelectric plants of Barra Grande and Machadinho, on the border between Rio Grande do Sul and Santa Catarina states. Alcoa has more than 6,000 employees in Latin America, with operations in Argentina, Brazil, Chile, Colombia, Peru, and Venezuela.

Energy-dependent Alcoa operates the second largest smelter in South America in Sao Luis, in Northern Brazil.

Oil and Gas News

Former Occidental Fields Bring in $1.1 Billion for Ecuador

Ecuador earned $1.1 billion last year from the sale of 22.1 million barrels of oil extracted from the former oil fields of the US' **Occidental Petroleum**, state-owned Petroecuador said Friday, according to Reuters. Petroecuador said it sold an average of 96,737 barrels of oil per day at a price of around $50 each between May and December. The cost of production per barrel was $4.74, lower than the $6.55 that

Special Q&A

What are the Implications of Nationalizing Venezuela's Utilities?

Q Venezuelan President Hugo Chavez on Monday announced sweeping plans to establish greater government control over the economy, including the nationalization of telecom and power companies, and stripping the Central Bank of its autonomy. What is the future of private investment in Venezuela in the wake of Chavez's speech? With US firms being the major investors in the companies targeted for nationalization, do you see an escalation of US-Venezuela tensions? How will the US respond to Chavez's moves?

A Guest Comment: Robert C. Helander: "Starting with his 'Bolivarian' constituent assembly to draft a new constitution, Chavez has consistently followed the recipe for boiling a frog: gradually raise the temperature by degrees, so that the frog relaxes until it is too late to jump out of the water. The only moderating force that can stop him is the price of oil. If prices stay at or near present levels, he has a gusher of money to fund his ambition. If he decides to nationalize foreign investments, he could take part of the money we pay him for oil to pay compensation and avoid an unnecessary confrontation. After all, he needs to sell us oil as much as we need to buy it. Meanwhile, his march toward 'socialism' sounds like the '60s and '70s in Latin America. 'Socialism' and fascism are but two ends of a political horseshoe, they are always closer to each other than either is to the democratic center. The difference this time is that Chavez has learned to manipulate the electoral process to maintain the appearance of democracy and he has the money to grease his way. A poor Chavez would have long since been laughed off the stage. Stay tuned."

A Guest Comment: Richard Francis: "The overall investment climate in Venezuela has clearly deteriorated in the last six years with increased government intervention in the private sector. As a result, foreign direct investment, includ-

Special Q&A continued from page 4

Special Q&A continued from page 3

ing the all-important oil and gas sector, has plummeted to an average of $2 billion per annum over the last five years from over $4.7 billion in 2000. Furthermore, although private investment has picked up locally, anecdotally it appears to be short-term and more speculative in nature. It is not clear the terms under which the government will take steps to nationalize the telecom and

"... The government has built an impressive amount of liquid assets that is estimated at $45 billion and could, therefore, choose to buy out the private investors in EDC and CANTV."

— Richard Francis

power companies; certainly an expropriation of assets would be the most radical measure. However, the government has built an impressive amount of liquid assets that is estimated at $45 billion and could, therefore, choose to buy out the private investors in EDC and CANTV. This route would be negative in terms of creating a more bloated public sector and likely impair the overall quality of services, but is unlikely to have much of an impact on the already deteriorated US-Venezuela relations. However, ultimately, the most important factor for Venezuela is the outlook for the oil and gas sector. 2007 will be a pivotal year for the direction the government takes with this sector as well. Clearly, major investments are needed to expand production and, without it, oil production will remain stagnant at best."

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Guest Comment: Beatrice Rangel: "The decision to nationalize CANTV and the electric power providers is the logical step to take by any autocratic regime. Once the institutional framework is safely under control, the next logical step is to seize the economic blood vessels. In the case of Venezuela, these are oil (which is state owned), foreign exchange (which is also under state control), telecommunications, and power. Telecoms and power are key to market economics, as wealth creation is nowadays a function of information and energy availability. Telecoms bear the highest strategic significance, as they confer control over electronic media while facilitating early suppression of dissent. After having enjoyed a landslide electoral victory, President Chavez needs to control these strategic services to secure long term control of Venezuela. From the foreign investor's perspective, this is dire news except for those investors that are expert riders in risky markets. Energy companies that have invested in Venezuela will have to learn to swim these waters at least until they recoup their investments. Over the long run, however, the country runs the risk of isolation from the world economy and technological change. With respect to the impact of this decision upon US-Venezuela bilateral relations, it simply adds a link to a never-ending chain of antagonistic relationships that stop short of a full crisis in light of the oil equilibrium. To be sure, neither the US can do without the oil procurement from Venezuela nor is Venezuela's oil basket likely to find other refining destination than the US. There will certainly be a lot of noise on how to apply the Hickenlooper Amendment to Venezuela, but Venezuela does not receive assistance from the US."

Robert C. Helander *is Managing Partner at InterConsult LLP in New York.*

Richard Francis *is Associate Director, Sovereign Ratings at Standard & Poor's.*

Beatrice Rangel *is a member of the daily* Latin America Advisor *board and President of AMLA Consulting in Miami.*

Editor's note: Venezuelan government officials were invited to remark on this topic; however, none agreed to comment on the record by press time.

Occidental had set on its budget to extract each barrel in 2006, according to Reuters. Petroecuador has operated the fields since May, when the government canceled Occidental's contract on charges the Los Angeles-based company had illegally transferred an oil block to another company. Occidental denies any wrongdoing and has filed a claim with an international arbitration court seeking $1 billion in damages and the return of its assets in the Andean country. Incoming President-elect Rafael Correa, who takes office next Monday, has called the contract cancellation and the seizure of Occidental's assets a "closed case." Petroecuador operates Occidental's Block 15 and the Eden-Yuturi and Limoncocha fields, which produce a combined average of 100,000 barrels of oil per day, or about one-fifth of Ecuador's total production of about 530,000 barrels per day. [Editor's note: see related Q&A in the June 28, 2006 issue of the Dialogue's *Energy Advisor*.]

PetroLatina Energy Optimistic on Colombia Reserve Outlook, but Guatemala Disappoints

United Kingdom-based **PetroLatina Energy Plc**, an independent oil and gas company, on Wednesday upgraded its view on the potential of its Midas and La Paloma licenses in the Middle Magdalena Valley in Colombia, but reported that it is declaring *force majeure* on much of its Guatemala operation. "The work on La Paloma has been completed and this has provided a significant upgrade in the potential of this license," the company said in a statement. PetroLatina now believes that unrisked recoverable resources of up to 90 million barrels (a net of 58.5 million barrels) exist on the La Paloma license, an increase from the initial view of 20 million barrels (a net of 13 million barrels). Work on the Midas license is ongoing and should be completed in the first quarter of 2007, the company said. PetroLatina is currently producing approximately 500

Nicholas Gay, CEO
Photo: PetroLatina Energy.

barrels of oil per day. While the company's outlook on Colombia brightened, its experience in Guatemala soured in recent months. The company's Atzam well in the Central American country was worked over in late 2006, it reported, and while they encountered a strong pressure regime and oil flowed to surface, the workover also identified damage to the casing and cement work which will require remedial work on the well bore to allow the well to be fully tested. In the company's Tortugas investment, despite completing what it thought were all necessary central government approvals and consents to start work on license A7-2005, the municipality of Coban refused to grant access to the Tortugas area of the license. "PetroLatina has therefore declared *force majeure* and all operations have been suspended on the license, with the exception of those related to Atzam-2. Accordingly, operating and administrative staff in Guatemala, together with other field and office costs, have been reduced to minimum necessary levels," the company said in a statement.

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>
> *– PetroLatina Energy*

Political News

Morales Supporters Set Fire to Cochabamba's Capitol Building

Supporters of leftist Bolivian President Evo Morales on Monday set fire to the provincial capitol building in the city of Cochabamba in a protest to demand the resignation of the province's opposition governor, the Associated Press reported. The burning of the capitol building followed clashes between provincial police and thousands of protesters in a plaza outside the building earlier in the day. Police used tear gas to try and disperse the protesters, who responded by throwing rocks. At least 22 people were reported hurt in the clash, including several journalists covering the event. The protesters, which included Indian groups, labor unions, and coca farmers, pledged to begin a blockade today of highways leading into Cochabamba. They have been demanding the resignation of provincial Governor Manfred Reyes Villa, a former presidential candidate and a vocal critic of Morales. Reyes has attacked Morales for seeking to rewrite the country's Constitution with just a simple, rather than two-thirds majority. Morales' Movement Toward Socialism party, or MAS, holds just over half of the seats in the assembly that is drafting the new Constitution. Reyes has also called for a second vote on a referendum to give Bolivia's nine provinces greater autonomy from the central government. The referendum was defeated in a nationwide election in July. Cochabamba was one of five western highland provinces to reject greater autonomy, while the four eastern lowland states favored it.

Economic News

Moody's Downgrades Outlook on Ecuador Ratings to Stable

Moody's Investors Service said Monday it downgraded the outlook on its ratings for Ecuador from "positive" to "stable." The New York-based ratings agency cited worries over plans by the incoming government of Rafael Correa to restructure the Andean nation's debt. "The high level of uncertainty with respect to the intentions of the incoming government to service its obligations prompted Moody's to review the positive outlook and reassess the trajectory of the country's ratings," Moody's analyst Alessandra Alecci said in a press release. Correa, who takes office next Monday, is a US-trained economist but has spooked markets with talk of restructuring some $10 billion in foreign debt.

POLITICAL BRIEFS

Lavagna Says He Will Make Presidential Run in Argentina

Roberto Lavagna, Argentine President Nestor Kirchner's former economy minister, said he would run for president in the country's October elections, local daily *La Nacion* reported on Friday. Lavagna, who is credited with helping bring Argentina out of one of its worst-ever economic crises in 2001-2002 and overseeing the restructuring of some $100 billion in defaulted debt, said he would continue to build on the country's four-year-old recovery and work to eradicate poverty.

Bush Calls to Congratulate Nicaragua's Daniel Ortega

US President George W. Bush called Nicaraguan President-elect Daniel Ortega to congratulate him on his election victory and express a willingness for cooperation after the Sandinista and longtime US nemesis takes office on Wednesday. White House spokesman Tony Snow said Bush expressed the US' "strong commitment to the well-being of the Nicaraguan people and our continuing interest in a relationship with Nicaragua, noting such ongoing areas of concern as CAFTA and the Millennium Challenge Account."

Kidnapped Ex-Colombian Minister Escapes from Rebels

Former Colombian Development Minister Fernando Araujo, who was taken hostage by FARC rebels in 2000, turned himself in at an army outpost on Friday after wandering in the wilderness for five days, local daily El Tiempo reported. Araujo had escaped from his captors during a helicopter raid. The former minister was among 62 hostages that the rebels have sought to exchange for comrades held in government jails.

Featured Q&A
Continued from page 1

even if prices fall, because the government has announced its intentions of tapping once again into the Central Bank when in need of cash."

A **Board Comment: Roger Tissot:** "The outlook for PDVSA is a continuation of the policies that we have seen in the last two years. Rafael Ramirez's reappointment is a clear expression of support for work that President Chavez perceives as being very successful, in terms of the migration of the 2005 operational contracts, as well as Venezuela's exposure in the promotion of its petroleum policy objectives. The main challenge as we move forward is for PDVSA to be able to meet its investment targets, which are quite ambitious. [As for addressing under-investment critics], it will be a challenge because Venezuela will face several issues. One is the process of negotiation on the Faja [heavy crude oil belt] which will obviously eat up most of the first part of 2007. It was optimistic to expect all those contracts to be signed by the end of December 2007, as the government was suggesting. The complexity of those contracts is substantial. And while those negotiations are being done, I doubt that investments will be moving forward. So businesses will be doing the basics necessary, but not really expanding. The second issue is prioritizing the confirmation of reserves on the Faja. This is work they are doing with state-owned companies that have been invited to do that work. That also is going to take some time, and how that work is going to be finished and integrated into the overall Faja vision will take more time. Finally, there is the desire to review PDVSA's stake in gas. That will mean additional negotiations. So the more we negotiate, the less we invest. [To deal with a steep fall in oil prices], I think that the strategy overall has been to keep maintaining support to a very hawkish position in terms of OPEC reduction and OPEC production. That is the only strategy they can afford, because in reality Venezuela is not a price-setter, especially since they are below quota. So the only thing they can do is stick with proposing a stronger cut for OPEC, as they did last year. But it is not guaranteed that those positions are going to be accepted all the time. When President Chavez took power again this year, he perceived that the election results showed a clear mandate to move forward with what he calls socialism for the 21st century. In the energy sector, that means more of the same in terms of wanting to increase the role of PDVSA as the operator of all the oil contracts, migrating all the existing contracts to the 2001 law—that should not be a surprise to anybody—and increasing PDVSA's role in the gas sector to finally move forward their desire to integrate Venezuela with the rest of South America through energy. So, the pipeline to Brazil, Petroamerica, and all of those issues are going to continue to be a priority. Foreign companies will have to work within that framework."

"... The pipeline to Brazil, Petroamerica, and all of those issues are going to continue to be a priority."

— Roger Tissot

Luis E. Giusti *is a member of the* Energy Advisor *board and Senior Adviser at the Center for Strategic and International Studies. He is a former CEO of PDVSA.*

Roger Tissot *is a member of the* Energy Advisor *board and Director of the Markets and Countries Group at PFC Energy.*

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