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Argentine Energy Law

1. Argentine Gas Market

Argentine Privatization Era

From its inception in 1920 to 1989, the Argentine public sector dominated both the upstream and downstream markets of the Argentine oil and gas industry. Then, in August 1989, in a sweeping reform measure, President Carlos Menem called for the privatization and deregulation of most major state-owned companies, including the oil and gas sectors. Law No. 23,696 (the "Privatization Act") implemented this broad mandate and established an emergency plan to reduce public expenses and improve the caliber of public services. The Privatization Act authorized the privatization of thirty-two (32) state owned companies, including *Yacimientos Petroliferos Fiscales* ("YPF") and the state oil and gas transportation and distribution systems company, *Gas del Estado* ("GDE"). Subsequently, the government also issued a series of executive decrees relating to the deregulation of energy activities.² Such decrees eliminated restrictions on imports and exports of crude oil and deregulated the domestic oil industry including the price of oil and petroleum products. Deregulation divided the oil industry into three different segments, production, transportation, and distribution, and eliminated the state-dominated central planning system whereby the country's entire domestic oil production was distributed by YPF to various state-owned refining companies according to established quotas. Nevertheless, since privatization and despite deregulation, YPF has maintained its position as the dominant actor in the Argentine oil and gas upstream and downstream markets.

Natural Gas Law

In June 1992, the Argentina adopted Law No. 24,076 (the "Natural Gas Law") that deregulated the transportation and distribution of natural gas. Under the Natural Gas Law, the sale of natural gas between gas producers,³ distributors,⁴ and gas traders was permitted based on free market forces. As a result of this process, two private companies, *Transportadora de Gas del Norte* and

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² Argentine Decree Nos. 1055/89, 1212/89, and 1589/89.

³ Major participants in the upstream Argentine gas market are Repsol YPF, Total Austral, Panamerican Energy, Wintershall, Pluspetrol, and Petrobras Energia.

⁴ Under the privatization model, gas distributors were assigned exclusive geographic areas. Major distributors include Camuzzi Gas (Gamuzzi Gas Pampeana and Camuzzi Gas del Sur are together the largest natural gas distributor in Argentina, providing gas to approximately 45% of the country in the two neighboring regions the Pampean and Patagonia), Metrogas (serving the federal capital of Buenos Aires and the southern and eastern part of the greater metropolitan area of Buenos Aires with approximately 26.6% national market share), and Natural Gas Ban, which serves the north and western part of the metropolitan area of Buenos Aires.

Transportadora de Gas del Sur were granted thirty-five year concessions to carry out gas transportation activities. With respect to natural gas distribution, Argentina originally authorized eight (8) distribution companies to provide exclusive service in their respective designated geographical area.⁵ A ninth distributor, Gas Nea, was added in 1997.

Recent Consolidation in Argentine Oil and Gas Market

Since privatization, Argentina has seen significant consolidation in the oil and gas market with foreign energy companies purchasing their smaller Argentine counterparts. In 1997, BP-Amoco acquired Bidas, forming Pan American Energy. In 1999, Repsol of Spain acquired YPF, then the largest company in Argentina, dramatically affecting the liquidity of the Argentine stock market. In 1999, Chevron acquired *Petrolera Argentina San Jorge*. Finally, in May 2003, state-owned Petrobras of Brazil acquired a majority stake in Argentina's remaining large independent oil company, *Pecom Energía* (the acquired company was subsequently renamed *Petrobras Energía*).⁶

Regulatory Authorities

The Secretariat of Energy is the federal agency within the Ministry of Economy that sets broad government policy in the natural gas sector. However, under the Natural Gas Law, a new regulatory entity, the *Ente Nacional Regulador del Gas* ("Enargas") was created to regulate the gas sector and specific regulations were adopted for such purpose.⁷ In particular, Enargas was formed to regulate the transmission, distribution, and marketing of natural gas, including gas trading, regulation of tariffs for transportation and distribution of natural gas, promotion of competition in the market, and promotion of long-term investment in the gas industry. The two main principles in this area are non-discrimination and open access for all carriers.

Argentine Political and Economic Crisis

Prior to Carlos Menem taking office, Argentina was in the throes of an economic crisis, characterized by hyperinflation and economic instability. President Menem advocated currency reform. "Convertibility," as it was known, was a currency board exchange rate system that pegged the Argentine Peso to the US Dollar on a one-to-one basis. Minister of Economy Domingo Cavallo implemented this system on the premise that consumers and investors would have more faith in the financial system if they knew that the government could not resort to its inflationary ways of the past if the Central Bank was not lawfully allowed to expand the money size beyond its hard currency reserves.

The policy worked at the outset and the combination of a stable currency and the massive sell-off of state-owned industries, prompted inflows of foreign investment, increased consumer confidence, and strong economic growth. President Menem, capitalizing on his popularity, convinced the Congress to amend the constitution to permit re-election, and subsequently won re-election in 1995. However, as economic growth slowed in the final years of his second term, he failed to win re-election to a third term and in 1999, Radical Party candidate Fernando de la Rúa took office.

⁵ The initial eight (8) concessionaires were Litoral Gas, Gas Natural Ban, Metrogas, Camuzzi Gas Pampeana, Camuzzi Gas del Sur, Distribuidora de Gas Cuyana, Distribuidora de Gas del Centro, and Gas Nor.

⁶ By 2003, these four surviving companies dominated the Argentine upstream oil market with 77% of local oil production.

⁷ The Secretariat of Energy is responsible for implementing governmental policies regarding the exploration, production, importation, and exportation of natural gas. It also sets national policy in the power sector.

President de la Rúa inherited a slumping economy and the president was unsuccessful in lifting the economy out of a prolonged recession, even with the assistance of returning Economy Minister Domingo Cavallo. In fact, in 2001, three different economic ministers (including Domingo Cavallo) served in the de la Rúa Administration. President de la Rúa resigned in 2001 as nationwide protests gripped the country.

By this time, it was clear that Convertibility could not survive and that a devaluation would be required, given the mounting public debt. In December 2001, President Rodríguez Saa announced the sovereign default on its obligations.⁸ After a ten-day period of civil unrest and political uncertainty, in January 2002, Congress appointed Peronist Party Eduardo Duhalde as interim President. In May 2003, Néstor Kirchner was elected President, defeating former president Carlos Menem in an uncontested run-off.

Emergency Law of 2001

In December 2001, Argentina passed the Emergency Law,⁹ revoking Convertibility, and officially ending Argentina's experiment with neo-liberal economic policies. Argentina's economic crisis, felt in all sectors of the economy, affected the successful oil and gas industry in a particularly severe way. The resulting devaluation of the Argentine Peso resulted in an abrupt and significant reduction of new investment in the gas sector. Also, as a result of this crisis, Argentine oil companies, facing little incentive for selling crude oil in the domestic market given higher prices on the international market, were pressured by the government into selling their oil to national refineries at artificially low prices. The government, desperate to raise money, also assessed taxes on exports of several commodities, including hydrocarbons such as oil, naphtha, and subsequently natural gas.

The situation was even worse for the gas industry. Lacking a developed international market for their gas, gas companies were subject to a mandatory conversion of US dollars to pesos, on a one Peso to one Dollar basis, of their natural gas prices, which were denominated in US Dollars. This process, known as "*pesification*," resulted in a reduction of real prices by two thirds of their original value. The government, concerned about the effect of rising prices on the public, restricted the ability of gas producers to increase prices.

The above mentioned reduction of gas prices (in real terms) resulted in increased demand for natural gas with little economic incentive to invest more resources in the sector. In particular, in response to the artificially low prices, many industries decided to replace other combustibles, such as fuel-oil, with natural gas. In addition, the country has been experiencing upward pressures in natural gas demand due to increased economic and industrial activity commencing in the first quarter 2003.

Gas Producing Basins

Argentina has four gas producing basins (Austral, Golfo San Jorge, Neuquén and Northwest), which currently supply natural gas to both domestic and foreign markets (Chile and Uruguay). Total gas production for 2004 is estimated at 133.6 million cubic meters per day (4.7 BCF). Nevertheless, production is also limited by the current transportation system, which needs more investment in

⁸ President Rodríguez Saa was appointed as interim President by the Congress and served only eleven (11) days before resigning.

⁹ Law No. 25,561.

order to expand its capacity. Faced with an unattractive market in which to sell and mounting losses, oil and gas companies limited or completely halted their Argentine investment plans in the immediate aftermath of the crisis.

Bilateral Investment Treaty Claims

As a result of these developments, several foreign investors (including several gas companies) filed claims under their respective Bilateral Investment Treaty¹⁰ with the International Center for Settlement of Investment Disputes (ICSID). In general, the petitioning foreign investors argue that the substantial reduction of tariffs (on an inflation adjusted basis) after *Pesification* violated their concession agreements, impeded their ability to pay off US Dollar denominated debts incurred in reliance on the concession contracts, and resulted in significant economic losses. The alleged estimated losses by energy companies arising out of *Pesification* are over US\$ 4 billion.¹¹ Resolution of these claims has proceeded slowly to date and by December 2003, Argentina had only begun to answer such claims.

Second Generation Reforms

In February 2004, the Argentine government passed a series of amendments to the legal framework, issuing Executive Decrees No. 180/04 and 181/04 in an attempt to solve the critical situation described above and to encourage gas producers and other key actors to make new investments in the gas sector in order to increase production. These second generation reforms introduced changes to the legal framework, some of which are inconsistent with regulatory principles contained in the Natural Gas Law and Enargas regulations. For instance, one such second generation reform abandoned the principle of uniform prices for all gas customers and introduced a market distinction between consumers and large industrial and commercial purchasers, providing for substantial differences on gas prices at wellhead for each of these segments, with the goal of giving consumers a price break.

The Second Generation Reforms introduced the following changes:

- Authorization of the formation of an Electronic Gas Market (MEG) in which all spot gas supply and transportation capacity shall be marketed. The EGM is to be implemented on the Buenos Aires Stock Exchange.
- Imposition of obligations to submit extensive financial and operational information to the Secretariat of Energy to enable the agency to better monitor and evaluate the industry.
- Establishment of a government sponsored fund to finance the construction of additional gas pipelines.
- Increasing the authority of the Secretariat of Energy to carry out policies in the gas sector that originally, when the privatization process began, were under the jurisdiction of Enargas.¹²

In March 2004, the government issued additional regulations, such as the Secretariat of Energy's Resolution No. 265, which authorizes the national authorities to ration natural gas exports in order

¹⁰ Argentina has BITs with several of its major trading partners, including the US, the UK, and Spain.

¹¹ Panamerican Energy, Totalfina-Elf, and British Gas (in connection with its Metrogas holding) are some of the BIT claimants. There are an estimated twenty (20) BIT cases brought by energy companies arising out of *Pesification*.

¹² Some energy analysts view the Secretariat of Energy as more politically responsive than the technocratic Enargas.

to ensure domestic supply.¹³ In May 2004, the Government also levied a 20% withholding tax on gas exports. This tax was also applied to other fuels, such as butane and other gas products.

Formation of New State Owned Energy Company

In an ironic twist and despite a lack of public resources, in May 2004, the government announced the creation of a new national, state-owned oil and gas company *Energía Argentina Sociedad Anónima* (“Enarsa”) which would play a key role in the development of exploration and production activities, especially in off-shore basins, by associating with other companies. Although private sector reaction has been lukewarm, Enarsa has generated more enthusiasm with state-owned oil companies in the region such as its counterparts in Bolivia, Brazil and Venezuela. In fact, Ali Rodriguez, chairman of Pdvsa, expressed interest in PDVSA partnering with Enarsa.¹⁴

2. Argentine Power Market

General Overview

Until the early 1980s, the Argentine power sector was largely in the hands of the State.¹⁵ This economic model remained intact until President Carlos Menem dramatically reorganized the sector with the passage of Law 24,065, which authorized the sale of assets to the private sector. The goal of Law 24,065 was to modernize the electricity sector by promoting efficiency, competition, improved service, and private investment. The law also had a profound, albeit indirect impact, at the provincial level, as virtually all of the provinces followed the regulatory and institutional guidelines of Law 24,065 and privatized their generation, transmission, and distribution facilities through public bidding processes.

Law 24,065 divides generation, transmission, and distribution into separate sub-sectors, each subject to different regulation. In order to prevent excess concentration, companies holding permits in one sector are prohibited from participating in the other sub-sectors. The new structure also recognized large users and brokers as new actors in the electricity market.

Under Law 24,065, distribution and transportation activities are treated as monopolies, are completely regulated by the State, and require a concession. Although the concession agreements of distributors do not impose specific investment parameters, distributors have the obligation to connect new customers and meet any increased demand. However, the expansion of existing transportation facilities by the respective concessionaires is not restricted. In contrast, generation, although regulated by the State, is not deemed a monopoly activity and is subject to free competition by new market entrants. Finally, the operation of hydroelectric power plants requires a concession from the State.

¹³ With few hydrocarbon resources of its own, Chile became the largest buyer of Argentine natural gas in the late 1990s. Historically dependent on hydroelectric power and susceptible to the related climatological risks, Chile became dependent on Argentine natural gas for 40% of its electricity. In a blow to regional energy integration, Argentine President Nestor Kirchner abruptly and without consultation ordered a reduction of up to 25% in exports of Argentine natural gas to Chile, which typically amount to 20m cubic meters per day. See *The Economist*, “What sort of neighbour is this?,” May 15, 2004.

¹⁴ In 2004, Venezuela announced that PDVSA’s US retail affiliate Citgo would enter the Argentine retail market.

¹⁵ Among the state-owned companies in this era were Agua y Energía Eléctrica Sociedad del Estado (“AYEE”), Servicios Eléctricos del Gran Buenos Aires (“Segba”), Hidroeléctrica Norpatagónica (“Hidronor”), and Comisión Nacional de Energía Atómica (“CNEA”). AYEE and Hidronor were never privatized.

Wholesale Electric Market

Another important regulatory development in the Menem Administration was the creation of a wholesale electricity market ("WEM"). Resolution 61/92 and subsequent related resolutions authorized the formation of the WEM, enabling Argentina to better allocate resources in this area. Under the WEM, a wholesale power marketplace was created in which generators, transmitters, distributors, large users, and brokers operate. Under the WEM, prices fluctuate based on market forces, and actors may buy or sell power on (i) the "term market," where prices and conditions are freely agreed upon by buyer and seller, (ii) the "spot market," where supply and demand are matched on a "real time" basis, and/or (iii) a seasonal spot market employing a price stabilization mechanism.¹⁶

The Regulatory Actors

There are three principal regulatory actors in the Argentine electricity sector. First, the Secretariat of Energy is the principal federal regulatory authority for the electricity sector. It establishes and carries out broad policies for the sector. The Federal Board of Electrical Energy, composed of representatives from each of Argentina's twenty-four (24) provinces, advises the Secretariat on policies related to the coordination and harmonization of these policies.

Second, operating under the Secretariat of Energy pursuant to Law 24,065, the Electric National Regulatory Entity ("ENRE") is an autonomous supervisory body responsible for, among other things, (a) enforcement of concession contracts, (b) certain competition aspects including review of mergers and oversight against unfair competition, (c) authorization of construction of new transmission facilities, (d) approval of tariffs for distribution and transmission activities, and (e) resolution of disputes within the WEM. The ENRE is managed by a five-member board of directors appointed by the executive branch of the Argentine government. Two of these five members are nominated by the Federal Board of Electrical Energy.

The third regulatory figure in the Argentine electricity sector is the *Compania Administradora del Mercado Mayorista Eléctrico S.A.*¹⁷ (referred to by its Spanish initials "Cammesa"). Formed in 1992 pursuant to Decree 1162/92, Cammesa is responsible for the operation of the WEM, including the dispatch of loads, calculation of wholesale prices, and service as a clearinghouse for WEM actors. Twenty percent (20%) of the shares of Cammesa are held by the Secretary of Energy and each of the four trade associations representing generators, transmitters, distributors, and large users owns twenty (20%), respectively. Currently, there are approximately 2,000 large consumers of power who participate in the WEM.

Increased Investment under Law 24,065

Under Law 24,065, private and foreign investment in the Argentine power sector increased dramatically. As mentioned above, virtually all electricity facilities were sold to private parties, with only a few isolated facilities remaining in the hands of the State (e.g. Argentina's two nuclear

¹⁶ Under this market stabilization effort, Cammesa sets a seasonal fixed price of electricity to be paid by distributors based on projections for electricity consumption and supply. In order to assure that payments by distributors will not result in overpayment or underpayment, the Secretary of Energy established a stabilization fund, designed on a quarterly basis (a) to pay generators in the event of a deficit and (b) reimburse distributors in the event of excess payment.

¹⁷ "Administrative Company for the Wholesale Electricity Market."

plants and Yacyreta, a hydroelectric plant located in the Province of Corrientes).¹⁸ As previously mentioned, virtually all provincial generation, transmission, and distribution facilities were also privatized, with the exception of the Cordoba and Santa Fe distribution companies. In addition to the approximately thirty (30) power plants that were privatized, from the period from 1992 to the present, more than twenty (20) new power plants were installed, representing approximately 5,000 MW of additional capacity.¹⁹

During this period, Argentina attracted US\$8 billion in investment in generation facilities, with natural gas powered facilities and hydroelectric facilities growing approximately 85% and 80%, respectively.²⁰ Despite the increase in natural gas fired generation facilities, Argentina remains very dependent on hydroelectric power (and by implication climatological risks), with this type of electricity representing 50% of the installed generation capacity in the country.²¹

During this same period, the transportation sub-sector attracted approximately US\$ 8 billion in investment, with high voltage international interconnection lines and related facilities with Brazil and Chile being particularly noteworthy. This international connection permitted the transportation of approximately 2,000 MW of electricity and deepened regional energy integration.

Impact of the Emergency Law 25,561

As a result of the 2001 economic crisis, the "Law of Public Emergency and the Reformation of the Exchange Regime N° 25.561" was adopted, which, among other things, "pesified" transportation and distribution tariffs. Companies in this sector were suddenly being paid in less valuable pesos and the renegotiation of these concession contracts was required. To date, this re-negotiation it is still in progress and is expected to conclude by the end of 2004.

The Road to Recovery

During the 1990s, Argentina earned a reputation as an attractive place to invest with a stable fiscal regime and gas and power industries which were leaders in the region in terms of liberalization and market development. In the coming years, Argentina will need an integrated plan supported by both the government and the private sector and meeting the new demands of the market to obtain the investment required to improve the welfare of Argentine society.

¹⁸ For national security reasons, ownership of nuclear facilities remains in the hands of the State. Argentina's two nuclear plants have a total installed capacity of 1,018 MW. A third reactor, the 600 MW Atucha II, has been under construction since 1981, but is not expected to become operational before 2007. South American Gas – Daring to Tap the Bounty (2003), p. 101.

¹⁹ See ENRE website at www.enre.gov.ar.

²⁰ See ENRE website at www.enre.gov.ar.

²¹ South American Gas – Daring to Tap the Bounty, p. 101.