

ABOGADOS & CONSULTORES

CORRESPONSALES DE
WILKINSON BARKER KNAUER LLP
Washington, D.C.

Edificio Teatro Las Palmas, Piso 5
Av. Las Palmas
entre Av. Libertador y San Camilo
Urbanización Los Caobos
Caracas 1050, Venezuela.
Teléfono: +58.212.794.0674 (MASTER)
Telefax: +58.212.793.2792

Bimonthly Newsletter

Issue 003

March 2002

Venezuelan Insight

ELECTRICITY SECTOR

- **Alarming threat of energy crisis**

In our last issue we referred to the threatening crisis that progressively approaches the electricity sector given the worrying water-level situation of the reservoir called "el Gurí" and the unavailability of sufficient thermo generation resources to satisfy demand.

Amongst the underlying causes bringing up the energy crisis 3 main factors are to be highlighted: First of all, an obsolete hence inefficient thermo generation infrastructure; second, the lack of maintenance of the existing generation infrastructure causing a considerable portion of it to stop operations (currently, only 2 of the 5 electricity generators of "Planta Centro" - the largest thermo electrical plant in Latin America - are operating.); third and last, governmental and private investors indifference before demand claiming for the installation of new electricity generators.

In Venezuela, whilst thermo generation has satisfied approximately 30% of demand, hydro generation has served the rest of it through the infrastructures built in the "Caroní" river ("Gurí" and "Macagua"). However, due to the weather alterations suffered worldwide and also forecasted to last for several years, hydro generation lost its accountability. Therefore, given the threat of a rigorous and imminent electric power rationing, the necessary steps to prevent a crisis of large proportions are to be taken in the short run. Such scenario mandates that different measures be implemented in order to weaken the effects of the crisis.

Following this line of thought, the Venezuelan

INSIDE THIS ISSUE

1 Venezuelan Insight

2 Regional Insight

For any follow up on these newsletter topics, please feel free to contact us at info@abogaconsult.com

President adopted through Presidential Decree # 1717 issued on March 22, 2002, and published on March 25, 2002 in Official Gazette # 37411, concrete executive measures aimed at countervailing the natural and circumstantial factors currently risking the continuity of the electricity service. Such Decree provides:

- (i) That prior authorization by the General Energy Division of the Mines and Energy Department, electricity companies shall be empowered **to modify the terms of their existing power supply contracts**, in order to establish limits on consumption.
- (ii) That prior issuance of reasoned administrative order, electricity companies shall be empowered **to award contracts without biddings** when seeking to diminish the risks of electric power shortage.
- (iii) That prior authorization by the Mines and Energy Department, particularly, State companies rendering electricity services shall be empowered to enter into **purchase agreements with independent power suppliers** with the purpose of serving demand in the country.
- (iv) That the Mines and Energy Department and the Production and Commerce Department shall establish **special rate adjustment mechanisms** which ease the implementation of power saving programs.
- (v) **Value added tax, import and custom duties two-year exonerations for the importation of goods - required for electric power generation** - by companies in this line of business. Such exonerations only cover the goods to be determined by the SENIAT, the Venezuelan tax administration agency. Interested tax payers shall request that the General Energy Division of the Mines and Energy Department certifies that the specific goods being imported will be employed in addressing the energy crisis. Once this requirement is fulfilled, the SENIAT shall attend to the exonerations requests and allow the imported goods out of the customs.
- (vi) **Value added tax two-year exemption for the supply of electric power** between electric power service companies, either directly or through interconnected systems.

- ***The financial and administrative control regime for State companies has been modified***

The recent modifications incorporated into the financial and administrative control legal regime applicable to State companies - particularly by means of the Public Sector Financial Administration Organic Act, and the Independent Entities, State Companies, Foundations, State Associations and Partnerships Assignment to Public Administration Agencies Act - have influenced some of the proceedings and requisites which such companies need to fulfill in order to enter into agreements, establish businesses, transfer property and undertake financial obligations. Therefore, the novelty of the current legal *status-quo* obviously demands a careful examination of the transactions being planned - in furtherance of the objective of diminishing the risks of electric power shortage - by State electric service companies.

- ***National Transmission Company among the plans of the Executive Branch***

Regarding the national infrastructure for electricity transmission and the services supported by it as elements of strategic importance for security, defense and national economic growth, the Executive Branch issued a Decree published in Official Gazette # 37400 on March 8, 2002, ordering the integration of a Commission by the Energy and Mines Secretary and the Planning and Development Secretary with the responsibility of proposing to the Venezuelan President such necessary measures for the creation of a National Electric Power Transmission Company. Accordingly, the Commission shall conceive and propose the mechanisms for allocating the assets of the State companies CADAFE and EDELCA to the formation of the corporate capital and equity of the new State company. In pursuing its *raison d'être*, the Commission may ask for the opinion of public officers and other persons specialized in the subject matter.

TELECOMMUNICATION SECTOR

- ***Long distance telephone services opening***

Consistently with the telecommunications opening process, on March 19, 2002, CONATEL issued an "Order Regarding Access by Local Telephone Service Users to Long Distance Telephone Services through Direct Dialing." Thus, Venezuela implements an operator selection mechanism involving an "independent third party" (the Data Base Manager or DBM, role played in Venezuela by NCS Pearson), who shall be in charge of validating the requests of those long distance operators selected by users and allowing that long distance calls be automatically carried through pre-selected networks. Although the regulations also provide for a "code dialing" selection mechanism allowing users to select the long distance operators of their preference on a per-call basis by dialing the prefixes assigned to such operators, for the

time being, the direct dialing mechanism will do. This mechanism shall be available from long distance operators starting April 5, 2002.

- ***"Resale" of telecommunication services***

The ability to legally provide fixed and mobile telephone services, domestic and international long distance telephone services, private network services, etc., implies the prior granting of service-specific telecommunication licenses by the Venezuelan Regulatory Entity, CONATEL. However, the resale of telecommunication services by third party vendors - as long as such services are technically rendered by a duly licensed operator - is not regulated in Venezuela. Consequently, the resale of telecommunication services constitutes a money-making opportunity for companies seeking to serve clients and to lightly and expeditiously take their share in this line of business without incurring in the associated costs and without undertaking the obligations that accompany telecommunication licenses. Thus, the possibility to legally resell telecommunication services - without authorization by the regulatory entity - opens a world of opportunities regarding services proposals that may now include telecommunication services alone or in addition to core offerings. All that is needed is imagination and good strategic partners duly authorized by CONATEL to technically provide the specific telecommunication services being resold. This is, precisely, one of the benefits brought by the new Telecommunications Organic Act and the opening, not yet exploited in the Venezuelan market.

CASE LAW TRENDS

- ***Modification of the jurisdictional competency regarding administrative contracts***

By its judicial decision of March 12, 2002, the Political-Administrative Court Room of the Supreme Tribunal of Justice established that "a coherent interpretation of number 14 of article 42 of the Supreme Court of Justice Organic Act in the light of the principles contained in the new Constitution and its original purpose as temporary organizer of the administrative jurisdiction", leads to the conclusion that regarding administrative contracts the jurisdictional competency of the Political-Administrative Court Room is generally limited to hear cases related to agreements to which the Republic is a party. Additionally, the jurisdictional competency to hear cases related to the interpretation, performance, expiration, nullity, validity or anticipated termination of administrative contracts to which a State or a Municipality is a party, resides only with the Political Administrative Court Room when the importance and impact of the case on the people so demands. Thus, cases not involving such importance and impact on the people - such as those relating to public lands - shall be heard by the regional Superior Administrative Tribunals. Therefore, until the new

Administrative Litigation Statute is enacted, judges and legal authors shall undertake the task of determining the scope of such "special importance and impact on the people" which is the governing rule of law to be applied when the jurisdictional competency is at bar regarding administrative contracts to which States and Municipalities are parties.

ECONOMIC NEWS

• ***Devaluation***

After the implementation of a free fluctuation scheme in mid February, the value of the national currency registered an abrupt descent with respect to the US\$ which reached quotations of more than Bs. 1,100.00 per US\$ 1.00. This meant a devaluation of almost 30%. However, as a consequence of the US\$ auctions conducted daily by the Venezuelan Central Bank, the exchange rate has tended to stabilization below the Bs. 950.00 per US\$ 1.00 level. Such situation triggered an inflation rate increase affecting even the prices of goods made in Venezuela.

• ***B.D.T. prints value on cash and subtracts value from electronic money.***

The Bank Debit Tax (B.D.T.) arrived to be imposed on all debits registered in accounts existing in financial institutions. This is clearly a rough mechanism that breaks the financial equilibrium in commercial relations. Thus - as usually done in the past to reduce the budgetary deficit - the Venezuelan State once again opted for disguising a confiscation with a robe of legality, allowing itself to take from account holders 0.75% of the amount of every bank debit without taking into consideration their tax paying capacity. Then, in such circumstances, businesses find themselves in a situation where optimization of their paying processes in function of the B.D.T. is necessary, as well as the reduction - to the maximum extent possible - of daily deposits in the financial system, in order to control the increase in their transactional costs and expenses. Accordingly, we see a clear business opportunity for cash transportation companies which may now offer a very attractive service to businesses that collect large amounts of cash from their customers every day. A cash transportation company, prior instructions from its clients, may take the cash collected by the latter from customers and make payments directly to its clients' suppliers before depositing the money in financial institutions and, therefore, legitimately escape the B.D.T. taxable event. In other words, the service would consist of using the cash before it becomes electronic money in financial institutions and falls under the umbrella of the B.D.T. Most probably, the service price will be lower than the amount of the B.D.T.

• ***Entering into force of the new Income Tax Act***

On February 19, 2002, a complaint requesting the nullification of article 199 - on the ground of its unconstitutionality - of the Income Tax Act (I.T.A.)

published in Official Gazette on December 28, 2001, was filed before the Constitutional Court Room of the Supreme Tribunal of Justice. Article 199 establishes that the new law enters into effect on the same day of its publication in Official Gazette. The complaint is based on the constitutional prohibition for tax laws to enter into effect on the same day of its promulgation, given that the Constitution mandates that every new tax law shall provide for a *vacatio legis* which must elapse before the new law enters into effect. Should the Supreme Tribunal rule in favor of the plaintiff, the new Income Tax Act will not be applicable to the fiscal year started on Jan. 1, 2002 but to the fiscal year starting on Jan. 1, 2003. That is, the new statutorily established prohibition to add or offset foreign losses to national losses or against national net income, the new dividends, inflation adjustment and transfer pricing regimes would not be applicable to the fiscal year started on Jan. 1, 2002; therefore, its application will have to be deferred for the fiscal year starting on Jan. 1, 2003. However, the complaint has not yet being admitted by the Constitutional Court Room despite its urgency.

Regional Insight

TOWARDS THE ANDEAN COMMON MARKET IN 2005

On their way towards the Common Market in 2005, the Andean Community countries are taking giant steps eliminating restrictions for commercial services in the sub-region. Particularly, such liberalization is already a reality regarding telecommunication services (except for radio broadcasting and television services). That is, under the schedule provided by Decision # 462 of the Andean Community Commission, all in-country restrictions that member countries could impose on such services have been removed, so currently, even local telephone services, domestic and international long distance telephone services and mobile telephone services have been liberalized. However, with respect to the practicality of such liberalization, it is fair questioning what its tangible benefits are - from a legal standpoint - for telecommunication companies planning to operate in more than one member country. Well, apparently none. In accordance with Decision 462, telecommunication service providers operating in any of the Community member countries may only establish, install, acquire, lease, exploit or supply networks or telecommunication services in any other member country, prior internal confirmation of their respective licenses. Such confirmation will be granted under the terms and conditions established by internal regulations of the granting member country and not according to the conditions rights and obligations provided by the license issued by the country of origin. Accordingly, given that the applicable regulations for the definition of telecommunication obligations services, their scope, as well as the rights and obligations associated

to such activities, shall be those provided by the national legislation of the specific member country granting confirmation of a license, a long way is still ahead to make different domestic service categories match in order to define several telecommunication services and identify the applicable regulatory framework within each member country. In facing this problem, the "functional equivalence" principle should definitely be of great use.

NEW FINANCING SOURCE FOR DEVELOPMENT

• *The Kyoto Protocol*

The Kyoto Protocol (December 11, 1997) of the United Nations Main Convention (May 9, 1992) is opening new doors to what will become an important financing source for developing countries with the capacity to absorb greenhouse effect gases (GEG) through forestry projects. Latin-American countries have a great opportunity to benefit from the sources obtained from selling Emission Reduction Certificates (ERC) that will be issued once they have fulfilled the requirements established by the Clean Development Mechanism (CDM), an international entity in charge of managing the program.

• *Carbon World Market*

Industrialized countries produce nearly 55% of the world pollution, affecting the climate and producing high temperatures whose consequences can be devastating. Through the Kyoto Protocol these countries commit themselves to reduce their greenhouse effect emanations (GEE) in 5% compared to the level registered in 1990 by the period between 2008 and 2012. This reduction is costly and it affects these countries' production processes. On the contrary, developing countries produce less GEE and besides, they have the capacity to clean the atmosphere at low prices. It is in these countries where the adequate use of natural resources can become an interesting source of income by offering industrialized countries forestry projects to reduce additional GEE to that which nature would absorb spontaneously without these projects existence. Having reached the adequate GEE through the financing of projects to reduce GEE, industrialized countries can fulfill their commitments under the Kyoto Protocol. The price of each ERC (equivalent to a ton of CO₂ that can be absorbed) is estimated between US\$ 6 and US\$19 depending on demand. Assigning these a low price of US\$10, a country like Colombia could receive an income close to US\$ 450,000,000.00 yearly.

• *Latin-American progress*

To access CDM resources countries need to go through a series of stages and requirements without which they will not be able to offer their projects. In first place, countries must participate voluntarily. They must ratify the Kyoto Protocol and name a national authority to manage their projects locally. Also, they must

overcome a series of complex stages until their ERCs are issued. Countries such as Colombia and Nicaragua have seen the potential of CDMs and they are ready to claim their share in a blooming market with few competitors who still remain uninformed. Venezuelans could use their potential oxygen sales to finance reforestation projects in areas such as the *Caroní* basin which has been severely affected by gold mining.