

COLOMBIA'S ECOGAS PRIVATIZATION PROCESS

By: Larry B. Pascal and Francisco Uribe

Per Decree 1404 issued on May 5, 2005 ("Decree 1404"), the Colombian Government approved the sale of the State's majority interest in the largest gas transportation company in Colombia, *Empresa Colombiana de Gas* ("Ecogás"). An introduction to Ecogás and the privatization process is set forth below.

1. Background

Colombia's gas industry has four important actors: (a) the National Agency of Hydrocarbons (*Agencia Nacional de Hidrocarburos* – ANH), a governmental agency which manages the country's hydrocarbons reserves; (b) a group of private companies, including Ecopetrol, Texaco, BP and Triton,¹ which currently carry out the vast majority of the exploration and development of natural gas reserves, (c) the Energy and Gas Regulatory Commission ("CREG"), a governmental agency which oversees regulation in this downstream area, and (d) Ecogás, a state-owned company overseen by the Ministry of Mines and Energy, which, together with a group private companies,² manages Colombia's transmission system and operates gas transportation pipelines in the country.³ The CREG has segmented the industry into production, transmission, distribution, and marketing sectors and regulates the system via resolutions covering matters such as production, transportation, distribution, marketing, and tariffs.

In 1997, Congress enacted Law 401 of 1997 by which the business of transportation of natural gas was spun-off from Ecopetrol into a new state owned company, Ecogás. Ecogás has the largest gas transportation network in Colombia.

Currently, one of the main goals of Colombia is to expand the distribution of natural gas to residential customers and to foster its use in automobiles. By 2010, it is expected that at least 4.5 million families will be using natural gas provided by the gas network. In connection with this goal, Colombia authorized the *Consejo Nacional de Política Económica y Social* ("Conpes") to evaluate the gas sector and make recommendations.

In 2002, Conpes, pursuant to Conpes document No. 3190/2002, recommended the adoption of a stable price policy and the adoption of measures to preserve the financial viability of Ecogás. Conpes followed-up this report with a new report a year later⁴ which analyzed the need to consolidate the natural gas industry in Colombia. Conpes' recommendation was to privatize Ecogás.

Ecogás operates approximately 3,644 kilometers of natural gas trunk pipelines in Colombia. The three main lines include (i) the Ballena-Barrancabermeja line, linking Chevron's Ballena field on the northeast coast to the city of Barrancabermeja in central Colombia; (ii) the Barrancabermeja-Nevia-Bogotá line, which integrates the Colombian capital, Bogotá, into the transmission network, and (iii) the Mariquita-Cali line through the western Andean foothills. There are other small stretches of pipeline operated by

¹ These companies carry out 95% of the gas production in Colombia.

² The other companies responsible for gas transportation are (i) Promigas S.A., (ii) Transoriente S.A., (iii) Transmetano, and (iv) Progasur.

³ Ecogás and Promigas S.A. manage 95% of Colombia's gas transmission system. Ecogás operates gas transportation pipelines in central and southern Colombia and Promigas S.A. does so in the north of the Country.

⁴ Conpes document No. 3244/2003.

private firms.⁵ The company directly operates approximately 1,829 kilometers of pipelines and approximately 1,815 kilometers of pipelines are operated by third parties through Build-Operate-Maintain-Transfer contracts (“BOMT”).

Ecogás’ total gas transportation network, including the BOMTs, represents approximately 70% of Colombia’s transportation pipeline system.⁶ In addition, Ecogás’ assets include several gas compression stations, three of them under BOMT contracts due for transfer in 2006, as well as other related transportation equipment, buildings, and land.

Pursuant to financial figures presented by Ecogás in its annual financial statements, Ecogás’ total assets as of December 31, 2004 were COP\$999,419,066,000 (approximately US\$438.3 million),⁷ an 8.73% increase from the previous fiscal year.⁸ Its operational income as of December 31, 2004 was COP\$338,807,577,000 (approximately US\$148.5 million), a 4.74% percent increase from December 31, 2003, with gross profits of COP\$183,538,341,000 (approximately US\$80.4 million) and net profits of COP\$170,794,955,000 (approximately US\$74.9 million). The large majority of Ecogás’ operational income comes from gas transportation tariffs charged to shippers of natural gas for the use of its network.

In 2004, measured by gross revenue, Ecogás was the second largest state owned company (after Ecopetrol) with gross revenue of COP\$263,291,000,000 (approximately US\$115.4 million). These financial results reflect the reforms in 2002 which granted greater autonomy to the company to be managed with a more market oriented approach.

2. Privatization Process

Following Conpes’ recommendation, the Colombian government announced in February 2005 that it would sell Ecogás as part of a privatization program that includes the sale of the following five electricity-generating companies: *Empresa de Energía de Cundinamarca*, *Electrificadora del Meta*, *Empresa de Energía de Boyaca*, *Electrificadora de Santander*, and *Centrales Electricas del Norte de Santander*.

The privatization process will be carried out according to the general framework for the privatization of state assets established in Article 60 of Colombia’s Political Constitution and further regulated by Law 226 of 1995.

Pursuant to these provisions, whenever the state is to dispose of its participation in an enterprise, whether a total or partial interest, it must take the necessary measures to “democratize” the ownership. The intent is to allow certain sectors of the society (primarily the workforce) to acquire some participation in the company. To achieve this purpose, the government is required by law to grant special purchase opportunities to (i) workers, retirees, and former workers (unless dismissed with cause) of the company being privatized and its subsidiaries, (ii) associations of workers and former workers of the entity being privatized, (iii) unions and associations of unions, and (iv) employee funds, mutual investment funds, severance and pension funds and other cooperative entities defined by law.⁹ These individuals, associations, and entities are known in Colombia as the *Sector Solidario* (“Solidarity Sector”).

⁵ The other companies responsible for gas transportation are (i) Promigas S.A., (ii) Transoriente S.A., (iii) Transmetano, and (iv) Progasur.

⁶ See Ecogás’ website at www.ecogas.com.co.

⁷ All currency conversions are based on the representative market exchange rate as of 11/10/2005 of 1USD = 2,280 COP.

⁸ Ecogás’ *Informe de Gestión*, www.ecogas.com.co.

⁹ Article 3 of Law 226 of 1995.

So as to encourage the acquisition of state interests by the Solidarity Sector, Law 226 of 1995 establishes among other special conditions, the following: (i) the shares being privatized must be offered first and on an exclusive basis to the Solidarity Sector; (ii) the sale price must be a fixed price per share based on the valuation of the company being privatized; and (iii) the shares must be offered to the Solidarity Sector when financial institutions (i.e. one or more) offer special lines of credit or payment terms to finance the acquisition of at least 10% of the offered shares.¹⁰

3. Ecogás Privatization

At this time, the Colombian government is planning to sell Ecogás by June 2006 (the deadline established by the Decree). By means of Decree 1404, the Government established the rules to govern the Ecogás privatization process. The total project value is estimated between US\$600 million and US\$1 billion. Santander Investment, the Colombian subsidiary of Spanish Grupo Santander, has been selected to serve as financial adviser for the project.

Decree 1404 contemplates the formation of a new company *Empresa Transportadora de Gas del Interior S.A., E.S.P.* (“TGI”). TGI will be capitalized by the Solidarity Sector and/or a strategic investor (national or foreign) (the “Investors”).¹¹ TGI will offer 75,000,000 of common shares.

The TGI capitalization process will be carried out by means of a successive subscription of shares (*suscripción sucesiva de acciones*) pursuant to Law 222 of 1995. This mechanism allows incorporation of the company via successive or subsequent subscription of shares, unlike the traditional method of simultaneous subscription of all issued shares at the time of formation of the company. Under this mechanism, the new company would be created if certain conditions are fulfilled. Detailed information regarding the formation of TGI is available in the *Programa de Fundación* (“Foundation Program”) prepared by Santander Investment.¹²

After the capitalization process, TGI will enter into an asset purchase agreement with Ecogás in order to acquire all of Ecogás’ assets, rights, and contracts.

Per Decree 1404 and the Foundation Program, the TGI capitalization process will be conducted in two phases: (i) in the first phase TGI’s shares will be offered to the Solidarity Sector; and (ii) in the second phase, the remaining TGI shares (not acquired by the Solidarity Sector) will be offered to Investors. Per Decree 1404, Investors must meet certain financial and technical requirements to qualify.¹³

In the first phase, 75,000,000 shares will be offered to the Solidarity Sector at a fixed price of COP\$10,000 (approximately US\$4.30) per share. As mentioned in Section 2, the Solidarity Sector may purchase shares under the special conditions set forth by Decree 1404.

In late December, 2005, the government is planning to make the preferred offer to the Solidarity Sector to purchase TGI’s shares. Pursuant to the Decree 1404, financial institutions may offer credit lines to the Solidarity Sector to acquire no less than 10% of the shares offered. It is expected that this process will take approximately two months. A virtual data room will be available to the public with information on the company once the offer to the Solidarity Sector is made.

¹⁰ Article 11 of Law 226 of 1995.

¹¹ The Decree establishes that investors may be national or foreign individuals and legal entities or trusts which meet certain requirements.

¹² The Foundation Program is available at www.ecogas.com.co.

¹³ See the Foundation Program for more details as to the financial and technical requirements.

The second phase of the process will take place after the offer to the Solidarity Sector is closed. It is estimated that the second phase of the process will take approximately two months. During this time, Investors will be invited to perform due diligence and present a binding offer for the remaining TGI shares and Ecogás' assets, rights, and contacts. The closing is expected to occur in June 2006.

The offer presented by Investors should include the price for the remaining TGI shares and the sum to be paid for Ecogás' assets, rights, and contracts. The share price in the second phase may be no less than the fixed price established for the first phase (COP\$10,000 per share).

The Investor that offers the highest price will have the right and the obligation to subscribe to all of the remaining TGI shares and Ecogás' assets, rights, and contacts.

4. Conclusion

While other Latin American countries have been seduced by the allure of populism, Colombia has taken a more market oriented approach to its hydrocarbon sector. This policy, first evidenced by the liberalization of the upstream market previously reserved solely to Ecopetrol, and now reflected by the proposed privatization of Ecogás, is indicative of the government's commitment to increase foreign investment in the sector. Under neo-liberal president Alvaro Uribe (who at this time enjoys high public approval and is contemplating a presidential re-election campaign), Colombia may defy the regional trend and create a vigorous private sector hydrocarbons market.

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