

**ENRON MEETING WITH TREASURY
IPP Dispute with GODR
February 18, 2000**

Enron: David Shields, Executive Director Caribbean Region

Treasury: Gay Sills, Greg Christopulos, Gene Clapp, Elizabeth Stewart, Gary Sampliner, Meg Donovan

Note: Enron distributed a chronology of the dispute entitled "Summary of Debt Crisis of the Independent Power Producers"

[(b)(4) . (b)(5)]

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DOMINICAN REPUBLIC THE SITUATION OF THE POWER SECTOR

1. SUMMARY

For the last 30 years the power sector of the Dominican Republic has gone through a chaotic situation. Although the present government has expressed the intention to resolve the problem, there are few signs of improvement to date. The main problems of the sector are (a) the lack of effective generation capacity to cover demand and to provide reserves for the system; (b) the weakness of the national transmission system; and (c) the high distribution and commercial losses. As a result, the country has been subject to constant power shortages and blackouts and the central government has subsidized the sector heavily.

Under these circumstances, it has been extremely difficult for the power sector participants, including Corporation Dominicana de Electricidad (CDE) and the Independent Power Producers (IPPs), to operate efficiently.

2. THE POWER SECTOR

CDE was created in the late 50's to replace the small private power companies that provided service to the cities in the country. During the 60's CDE operated efficiently, but quality of service started to decline steadily during the 70's. The reason? The government, owner of CDE, established a policy of providing electricity to all Dominicans, regardless of their needs and capacity to pay. In most instances service was provided free of charge.

In the 1990's, several private companies have entered into the sector by constructing and owning generation facilities. Presently there are seven projects operated by different investor groups. The total capacity of the IPPs is 600 MW.

3. MAIN PROBLEMS OF THE SECTOR

A. Management of CDE. Traditionally, the management of CDE has been considered a political prize and the General Administrator has been nominated directly by the President of the country. Because of the nature of the process, political appointees achieve their position without regard to training and experience. Even when a capable Administrator was appointed, he found no political support and had to work with an institution traditionally incapable, where private and often corrupt interest prevailed.

In the absence of experienced leadership, small nuclei of power developed within CDE. A typical example is the Office for Control of IPP's, which often in an authoritarian and unilateral way decides on how to interpret Power Purchase Agreements (PPAs), or what amount of the monthly invoices presented by IPPs should be paid, or when to pay the IPPs, etc.

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B. Financial Situation of the Sector. Due to very high-energy losses and poor commercial practices (discussed below), CDE has been for the last three decades in a precarious financial situation. This circumstance continues at present. To keep the utility in operation the central government has contributed millions of dollars every year to cover partially or totally CDE's financial costs (including debt service for IDB's and World Bank's loans). It is estimated that in 1997 the central government transferred to CDE about US\$200 million; in addition, the government decided to purchase with public funds new generation.

4. DEMAND AND GENERATION CAPACITY

Demand for electric energy by CDE's customers (representing about 70% of total country demand) has grown steadily. In the last few years demand has grown at an annual rate of 8 to 10%. In 1997 maximum (peak) demand on CDE's system was 1,200 MW, which CDE could not cover due to a lack of operable generating capacity. CDE's available or effective capacity (including IPPs generation) in 1997 ranged from 70% to 90% of demand and only on a few days could full demand be met. The causes of the shortage were (a) the poor maintenance of CDE's thermal plants (on average, only 45% of CDE's 1200 MW installed capacity has been operable); (b) two consecutive dry years that limited the output of CDE's hydro electric plants from 400 MW to as low as 160 MW; and (c) mechanical problems at the power plants of several IPPs.

A well designed power system should have operable generation reserves of 15% to 25% over the maximum expected demand. When planning available capacity, the hydro plants should be rated based on the output during a hydrologically dry year. Considering a 20% reserve margin, in 1997 CDE should have had 1,440 MW of available (or effective) capacity. The purpose of a generation reserve margin is to provide back-up for sudden outages of any power plant (including IPP's) and for scheduled outages for preventive maintenance. Inclusion of the IPPs in the generation segment of the power sector has reduced the capacity constraints faced by the systems' customers. However, these enterprises and CDE's generating units are subjected to problems in transmission and distribution, which they do not control.

5. SITUATION OF THE TRANSMISSION SYSTEM

CDE's high voltage transmission system is weak. It does not (a) permit steady transfer of energy under emergency conditions (for example, due to the outage of power plants) and (b) provide back-up for the outage of a main line due to mechanical problems (such as lightning and mechanical failure). Very often, the failure of a line results in a chain reaction that isolates all main power plants. Restoration of service may take several hours.

With the financial assistance of the World Bank and the technical assistance of the German consultant DECON, CDE completed in 1996 a Ten Year Master Plan for the Expansion of the Transmission System. An investment of over US\$140 million is required. So far, CDE has not begun implementation of the Plan.

6. HIGH DISTRIBUTION LOSSES

CDE's energy losses are the highest of any system in Latin America and perhaps in the entire world; 48% of the power input to the system is lost and is not billed to any customer. An estimated 40% of the total losses are due to technical reasons, and the other 60% are due to illegal connections, service without meters (70% of CDE's 800,000 customers have no meters) and CDE's billing errors (some of which are "arranged" by CDE's employees). Of the remaining 52% of energy billed by CDE, only 70% are actually collected. Therefore, about 64% of CDE's generation (own plants, plus IPPs) is lost and only 36% produces revenue for CDE. In summary, out of every three kWh that CDE sends to the system, only one

kWh generates revenue. The other two kWh are lost or not collected. The situation is similar to a storeowner ("colmado") who must buy three sacks of rice to sell only one sack (the other two being lost or stolen). No one, not even CDE, can survive such commercial operation.

A word regarding electricity rates: in 1997 the average price of electricity sold by CDE was 12.0 US cents/kWh. Average price paid by CDE to the IPPs was about US cents 7.0 per kWh and the average price of generation from CDE's own plant was 6.0 US cents/kWh. If losses were "normal" (even as high as 20%) and all bills were collected, the margin between cost of generation and selling price should be ample to permit a profitable operation.

7. RELATIONS OF CDE WITH THE IPPs

CDE depends heavily on the generation from IPPs. In 1997 the IPPs provided about 43% of 7,000 gWh input to the system. This contribution was made despite the fact that these same IPPs have less than 30% of the nominal generating capacity on the system. However, due to its poor financial situation, CDE cannot meet its financial obligations with the IPPs. At the end of 1997, the amount due by CDE to the IPPs was about US\$80 million (including amounts disputed by CDE). In the case of SECLP at the end of 1997 total amount due by CDE reached US\$38 million of which \$32 million are amounts disputed by CDE.

8. THE FUTURE OF THE POWER SECTOR

President Leonel Fernandez is committed to resolve the power sector problems of his country. Toward this end his administration has submitted to Congress the Electricity Law; hopefully it will be passed in 1998. This should allow the privatization of CDE, which has been initiated, to conclude successfully. There is a general consensus among most political parties that the only realistic solution to the power crisis is to let the private sector participate in all aspects of the business. This involvement will bring to the power sector contributions of new capital as well as efficient operating and administrative processes. Out of the restructuring CDE will come fiscally sound power companies and much more reliable electric service for the people of the Dominican Republic.

2/19/98

From: Elisabeth K. Stewart
To: Dom13.DOPOS(BLOOMGARDEND, CHRISTOPULOS, CLAPP, MC...
Date: 11/22/99 12:44pm
Subject: DR Meeting -Reply -Reply

Enron DC reports that the \$130m in arrears has arisen because in June, as part of the privatization process, the Government stopped its long-standing subsidy to CDE - which amounted to about \$5m a week. CDE thus had no money to pay the IPPs. Enron reports that all IPPs were treated the same and views the issue as one of "transitional privatization". Enron comments that going forward, budget allocation needs to be made to pay privatized distribution companies for GoDR power consumption (Enron estimates to be about 25 percent, for which reportedly GoDR did not pay in the past).

[(b)(5)]

>>> Meg Donovan 11/22/99 11:38am >>>
Greg Christopoulos asked me to phone the Embassy for a read out on Friday's meeting with the IPPs at the Presidential Palace.

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>>> Gene Clapp 11/19/99 05:59pm >>>
FYI: Briefing memo attached

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