

# SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## FORM 20-F

(Mark One)

REGISTRATION STATEMENT PURSUANT TO SECTION 12(B) OR (G) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended: December 31, 1999

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from to .

Commission file number: 1-13.396

**TRANSPORTADORA DE GAS DEL SUR S.A.**  
(Exact name of Registrant as specified in its charter)

Argentina

(Jurisdiction of incorporation or organization)

Don Bosco 3672

5th Floor

1206 Capital Federal

Argentina

(Address of principal executive offices)

**Securities registered or to be registered pursuant to Section 12(b) of the Act:**

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
American Depositary Shares, representing Class "B" Shares Class "B" Shares, par value Ps.1 each	New York Stock Exchange New York Stock Exchange*

\_\_\_\_\_  
\*Not for trading, but only in connection with the registration of American Depositary Shares, pursuant to the requirements of the Securities and Exchange Commission.

**Securities registered or to be registered pursuant to Section 12(g) of the Act:**

None

**Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:**

None

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the Annual Report:

Class "A" Shares, par value Ps.1 each	405,192,594
Class "B" Shares, par value Ps.1 each	<u>389,302,689</u>
	<u>794,495,283</u>

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes \_\_\_\_\_ X \_\_\_\_\_ No \_\_\_\_\_

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 \_\_\_\_\_ Item 18 X

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## PRESENTATION OF FINANCIAL INFORMATION

Transportadora de Gas del Sur S.A. ("TGS" or "the Company") maintains its financial books and records and publishes its financial statements in Argentine pesos. In this Annual Report, references to "pesos" or "Ps." are to Argentine pesos, and references to "US dollars", "dollars" or "US\$" are to United States dollars. A "billion" is a thousand million. References to "m<sup>3</sup>" are to cubic meters, to "Mm<sup>3</sup>" are to thousands of cubic meters, to "MMm<sup>3</sup>" are to millions of cubic meters and to "Bm<sup>3</sup>" are to billions of cubic meters. References to "cf" are to cubic feet, to "MMcf" are to millions of cubic feet, to "Bcf" are to billions of cubic feet, to "d" are to day and to "HP" are to horsepower. Argentine law requires *Banco Central de la República Argentina* (the "Central Bank") to sell dollars at the rate of one peso per dollar. The offered rate quoted by *Banco de la Nación Argentina* for the sale of U.S. dollars for pesos at close of business on December 31, 1999 and on February 7, 2000 was Ps. 1.00 = US\$ 1.00. See "Exchange Rates" for information regarding the ratio of exchange between the peso and the dollar from January 1, 1995 to the present. The Federal Reserve Bank of New York does not report a noon buying rate for pesos.

The Company prepares its financial statements in conformity with generally accepted accounting principles in Argentina ("Argentine GAAP"). Argentine GAAP differs in certain significant aspects from generally accepted accounting principles in the United States of America ("US GAAP"). Note 12 to the Company's financial statements, included elsewhere herein, provides a description of the significant differences between Argentine GAAP and US GAAP as they relate to the Company and a reconciliation of shareholders' equity at December 31, 1999 and 1998 and net income for the years ended December 31, 1999, 1998 and 1997.

The Company's financial statements include the effects of inflation up through August 31, 1995, utilizing the inflation restatement methodology established in Technical Resolution N°6 of the Argentine Federation of Professional Councils in Economic Sciences ("TR N° 6"). Effective September 1, 1995, as provided by rules issued by the Argentine Securities Commission (Comisión Nacional de Valores -"CNV"), the Company discontinued the restatement methodology, maintaining the effects of inflation accounted for in prior periods. The discontinuance of inflation accounting is in compliance with Argentine GAAP, provided that the annual variation in the general level wholesale price index ("GLWPI") does not exceed 8% per annum. Inflation for each of the years ended from September 1, 1995 was lower than 8%. Therefore, the criteria adopted by the Company is in compliance with Argentine GAAP. Financial statements for the years ended December 31, 1999, 1998 and 1997 are presented on a historical basis, except for non-monetary assets and their related consumption and shareholders' equity accounts, which have been restated through August 31, 1995.

Certain amounts shown in this Annual Report have been subject to rounding adjustments, accordingly, figures shown as totals in certain tables may not be an exact arithmetic aggregate of the other figures in such table.

## EXCHANGE RATES

Fluctuations in the exchange rate between pesos and dollars will affect the dollar equivalent of the peso price of the Company's Class "B" Shares on the Buenos Aires Stock Exchange ("BASE") and, as a result, are likely to affect the market price of the ADSs ("American Depositary Shares"). Currency fluctuations will also affect the dollar amounts received by holders of ADRs on conversion by the Depositary of cash dividends paid in pesos on the underlying Class "B" Shares.

As a result of inflationary pressures, the Argentine currency was devalued repeatedly during the approximately 30-year period ending in 1991. During that period, the economic authorities in Argentina utilized a number of exchange rate systems and macroeconomic instability led to broad fluctuations in the real exchange rate of the Argentine currency relative to the dollar.

Prior to December 1989, the Argentine foreign exchange market was subject to exchange controls. Since December 1989, however, Argentina has had a freely floating exchange rate for all foreign currency transactions. Since April 1, 1991, when Convertibility Law No. 23,928 and Decree No. 529/91 (collectively, the "Convertibility Law") became effective, the peso has been freely convertible into dollars. Under the Convertibility Law, the Central Bank (i) is required to sell dollars to any person who so requires at a rate of one peso per dollar and (ii) must maintain a reserve in foreign currencies, gold, net claims on the *Asociación Latinoamericana de Integración* ("ALADI"), and certain public bonds denominated in foreign currency (such bonds not to exceed 30% of such reserve), all valued at market prices, at least equal to the monetary base (which consists of currency in circulation and peso deposits of the financial sector with the Central Bank).

The following table sets forth, for the years indicated, the high, low, average and year-end exchange rate for the purchase of dollars, expressed in nominal pesos per dollar. The Federal Reserve Bank of New York does not report a noon buying rate for pesos.

<u>Year ended December 31,</u>	<u>Free rate</u>			
	<u>High</u>	<u>Low</u>	<u>Average<sup>(1)</sup></u>	<u>Year end</u>
1999.....	1.0000	1.0000	1.0000	1.0000
1998.....	1.0000	1.0000	1.0000	1.0000
1997.....	1.0000	1.0000	1.0000	1.0000
1996.....	1.0000	1.0000	1.0000	1.0000
1995.....	1.0001	0.9990	1.0000	1.0000

(1) Average of month-end rates.

Source: Banco de la Nación Argentina; Reuters.

## PART I

### ITEM 1. DESCRIPTION OF BUSINESS

#### INTRODUCTION

TGS is the largest transporter of natural gas in Argentina, currently delivering approximately 60% of the country's total gas consumption through 6,987 km (4,336 miles) of pipelines with a current delivery capacity of approximately 58 MMm<sup>3</sup>/d (approximately 2.0 Bcf/d). Substantially all of TGS's capacity is subscribed under firm long-term transportation contracts. TGS is also the largest processor of natural gas and the third largest marketer of liquid petroleum gases ("LPGs") in Argentina. The Company also operates the General Cerri gas processing complex and the associated Galván loading and storage facility in Bahía Blanca - Buenos Aires Province (the "Cerri Complex") where natural gas liquids are separated from gas transported through the Company's pipeline system and stored for delivery.

TGS, incorporated as a sociedad anónima under Argentine law, commenced commercial operations on December 29, 1992, as the largest company created in connection with the privatization of Gas del Estado S.E. ("GdE"), the state-owned gas company, whose integrated operations included gas transportation and distribution. GdE was divided into ten companies: two transportation companies and eight distribution companies.

TGS holds a 35-year license ("the TGS License"), extendible for an additional ten-year period at the option of TGS if certain conditions are met, giving it the exclusive right to operate the existing southern Argentine gas transportation pipeline system. The TGS system connects major gas fields in southern and western Argentina with distributors of gas and big users in those areas and in the greater Buenos Aires area, the principal population center of Argentina.

The rate-setting methodology contemplated by Law No. 24,076 ("the Natural Gas Act") and the TGS License is the "Price-cap with periodic review" model. Under this model, transportation rates are subject to semi-annual adjustments as a result of changes in the US Producer Price Index –Industrial Commodities– ("PPI") and in certain other circumstances. Also, transportation rates are adjusted by an efficiency factor and an investment factor. The Ente Nacional Regulador del Gas ("ENARGAS") is responsible for determining the rates that are to be effective during each succeeding five-year period following the initial five-year period that ended on December 31, 1997. At the end of 1997, TGS and ENARGAS settled the first general tariff review that established transportation rates for the period from January 1, 1998, through December 31, 2002. The settlement includes, among other things, a one-time, up-front tariff reduction of 6.5%, as a consequence of the application of the efficiency factor. In connection with the investment factor, ENARGAS approved periodic increases through January 2002 to TGS tariffs resulting in a total weighted average of 2.6% as of that date, to compensate the Company for approximately US\$ 70 million in investments. The settlement also includes a framework for promoting and pricing future system expansions. For more description about the rate review process, see "Description of Business - Gas Transportation - Regulatory Framework - Adjustment of Rates".

Industry segment information for the years ended December 31, 1999, 1998 and 1997 is set forth in Note 3. to the Company's financial statements included elsewhere herein.

TGS's controlling shareholder is Compañía de Inversiones de Energía S.A. ("CIESA"), which together with Perez Companac and Enron Corp. ("Enron"), hold approximately 70% of the Company's common stock. The shares of CIESA are currently held 50% by Perez Companac S.A. ("PC") and a subsidiary, and 50% by subsidiaries of Enron. The remaining ownership of TGS's capital stock is held by local and foreign investors.

TGS's principal goal is to maximize shareholder value through consistent, sustainable growth in operating results while positioning the Company among the market leaders through an unwavering commitment to quality and service to the community, its customers and its employees. The Company has recently decided to readdress its business towards growth and the development of local and regional opportunities. To that end, Company management set forth its strategic objectives for the year 2000 and beyond as follows:

- *Growth in gas transportation:* In this segment, the Company plans to generate growth opportunities, both in the local and in the regional market. In Argentina, TGS expects to increase its current 60% share in the Argentine gas transportation markets. In the region, the Company intends to join existing gas exportation projects to bordering countries, to link the important gas reserves connected to the Company's gas transportation system to the regional energy potential demand;

- *Expand gas processing activities:* The Company will direct efforts towards expanding its current business as a gas processor to become an important player in the broader natural gas liquids segment, both upstream and downstream of its processing complex. To that end, the Company plans to enter into strategic alliances with both gas producers and marketers of natural gas liquids;
- *Increased market in upstream services:* The Company will continue with its current strategy of increasing its share of the total natural gas treated and injected in Argentina's gas transportation systems by means of the acquisition and/or construction and/or operation of related assets;
- *Optimal financial management:* Management will continue to focus its efforts on the development of an optimal capital structure, consistent according with the company's growth steps, and the extension of the Company's average debt maturity;
- The reinforcement of processes designed to reduce operating and maintenance expenses;
- The continuous enhancement of system safety and reliability; and
- The optimization of the Company's assets.

## **GAS TRANSPORTATION - REGULATED BUSINESS**

As a transporter of natural gas, TGS receives gas owned by a shipper, typically a gas distributor, at one or more receipt points on the TGS system for transportation in the pipeline and delivery to the shipper at specified delivery points along the system. Under applicable law and the TGS License (see "Regulatory Framework" below) TGS is not permitted to buy for resale or to sell natural gas.

The TGS pipeline system connects major gas fields in southern and western Argentina with distributors of gas in those areas and in the greater Buenos Aires area, the principal population center of Argentina. Transportadora de Gas del Norte ("TGN"), the only other natural gas transportation operating company that supplies the Argentine market, holds a similar license with respect to the northern pipeline system, which also provides gas transportation services to the greater Buenos Aires area.

Gas transportation accounted for approximately 82% of TGS's total net revenues in 1999 and 88% in both 1998 and 1997. Approximately 93% of TGS's 1999 average daily gas deliveries were primarily made under long-term firm transportation contracts entered into with four gas distribution companies that also were formed upon the privatization of GdE (See "Customers and Marketing" below) and with big users. Firm contracts are those under which capacity is reserved and paid for regardless of actual usage by the customer. Substantially all of TGS's remaining gas deliveries were made under interruptible transportation contracts entered into in most cases with the same four gas distribution companies and YPF. Interruptible contracts provide for the transportation of gas subject to available pipeline capacity. All of TGS's firm contracted capacity is currently subscribed at the maximum rates allowed by ENARGAS.

### **Customers and Marketing**

The principal service area of TGS is the greater Buenos Aires area in central eastern Argentina. The Company also serves the more rural provinces of western and southern Argentina. The service area contains approximately 4.3 million end-users, including approximately 3.1 million in the greater Buenos Aires area. Direct service to residential, commercial, industrial and electric power generation end-users is mostly provided by four gas distribution companies in the area, all of which are connected to the TGS system: *MetroGas S.A.* ("MetroGas"), *Gas Natural BAN S.A.* ("BAN"), *Camuzzi Gas Pampeana S.A.* ("Pampeana") and *Camuzzi Gas del Sur S.A.* ("Sur"). These distribution companies constitute four of the nine distribution companies (eight of which were established upon the privatization of GdE) and collectively serve 66% of the Argentine distribution market in Argentina. The other five distribution companies (one of which is not currently operational) are located in and serve northern Argentina and are not connected directly to the TGS system.

The table below contains certain comparative information for the twelve-month period from October 1998 through September 1999 relating to the distribution companies which are connected to TGS pipeline system.

Company	Annual Deliveries (Bm <sup>3</sup> )	% of Market Argentina	No. of Users (in million)	% of deliveries received from TGS
MetroGas (1)	5.7	23%	1.9	99%
Pampeana (1)	3.9	16%	0.8	98%
Sur	3.4	14%	0.4	100%
BAN (1)	3.0	12%	1.2	57%

(1) Also connected to TGN system.

The firm average contracted capacity for TGS distribution company customers and for all other customers as a group at December 31, 1999, 1998 and 1997, together with the net revenues derived from firm gas transportation services accounted for by each of them during such years, and the net revenues derived from interruptible services for 1999, 1998 and 1997 are set forth below.

	December 31,								
	1999		1998		1997				
	Average firm contracted capacity	Net revenues (million of pesos)	Average firm contracted capacity	Net revenues (million of pesos)	Average firm contracted capacity	Net revenues (million of pesos)			
<b>Firm:</b>	(MMm <sup>3</sup> /d)	(MMcf/d)	(MMm <sup>3</sup> /d)	(MMcf/d)	(MMm <sup>3</sup> /d)	(MMcf/d)			
MetroGas.....	20.918	738.7	162.6	21.210	749.0	166.4	22.070	779.4	180.8
Pampeana.....	11.674	412.3	71.9	11.960	422.4	73.8	11.861	418.9	78.0
BAN.....	7.388	260.9	48.0	7.215	254.8	47.5	6.934	244.9	48.6
Sur.....	6.806	240.4	15.8	7.150	252.5	17.5	7.125	251.6	19.2
Others.....	9.454	333.8	47.0	7.896	278.9	36.3	6.546	231.2	32.0
Total firm.....	56.240	1,986.1	345.3	55.431	1,957.6	341.5	54.536	1,926.0	358.6
<b>Interruptible:</b>	—	—	8.2	—	—	4.8	—	—	4.1
Total.....	56.240	1,986.1	353.5	55.431	1,957.6	346.3	54.536	1,926.0	362.7

**Step-down Rights.** As part of the privatization process, the Argentine government allocated the then existing capacity of the GdE pipeline systems among the various gas distribution companies. To effect this allocation, firm transportation contracts between the distribution companies and the transportation companies were executed prior to their transfer to the successful bidders. Originally, the contracts had ten-year terms subject to annual renewal at the expiration of that period and included specific “step-down” provisions which permitted the distribution companies to reduce some of their committed capacity for each zone (as a percentage of the initial capacity) on specified dates from 1994 through 2001. Currently, the Company’s exposure to its customers (Metrogas, BAN and Sur) remaining step-down rights represents approximately 12% of its current contracted capacity. The following chart shows the years since when the step-down rights could be exercised:

	2000	2001	2002	2003	2004/2005	Total
MMm <sup>3</sup> /d.....	1.0	0.5	1.0	-	4.3	6.8
MMcf/d.....	35.3	17.7	35.3	-	151.9	240.2

Within the scope of the open season conducted during the years 1998 and 1999 (see “Pipeline Expansions”), ENARGAS made TGS grant all the shippers the right to exercise step-down rights. Such rights could be exercised if, as a result of such open season, new shippers subscribed firm transportation capacity in the same zones (from the reception to the delivery point) as the original shipper and provided TGS did not suffer any economic damage. ENARGAS’s intention is to make a more efficient use of the transportation system avoiding over subscribed capacity above market needs. Additionally, ENARGAS requested from TGS to apply this scheme to all on coming open seasons.

In connection with the waiver of step-down rights, if a customer of the distribution company that had foregone its step-down rights enters into a firm transportation agreement either directly or indirectly with the Company (“by-pass”), then the distribution company will have the right to reduce its firm transportation commitment with the Company up to the amount of the lost service between the distribution company and the customer. Accordingly, by-pass arrangements in the affected service areas may be less economically attractive to the Company than would otherwise be the case.

## Pipeline Operations

**Pipeline Deliveries.** The following table sets forth the average daily firm and interruptible transportation deliveries for 1999, 1998 and 1997 provided by TGS to its customers:

	December 31,					
	1999		1998		1997	
	Average daily deliveries		Average daily deliveries		Average daily deliveries	
Firm:	(MMm <sup>3</sup> /d)	(MMcf/d)	(MMm <sup>3</sup> /d)	(MMcf/d)	(MMm <sup>3</sup> /d)	(MMcf/d)
MetroGas .....	15.4	618.0	14.9	526.2	16.1	568.6
Pampeana .....	9.7	342.6	10.1	356.7	10.4	367.3
Sur.....	5.1	180.1	5.2	183.6	5.1	180.1
BAN.....	5.4	190.7	4.4	155.4	4.1	144.8
Others.....	8.8	236.6	4.0	141.2	4.0	141.2
Total firm .....	44.4	1,568.0	38.6	1,363.1	39.7	1,402.0
<b>Interruptible:</b>	3.4	120.1	3.1	109.5	2.1	74.2
Total.....	47.8	1,688.1	41.7	1,472.6	41.8	1,476.2
Average annual load factor (1) .....	85%		75%		77%	
Average winter heating season load factor (1)....	99%		90%		88%	

(1) Average daily deliveries for the period divided average daily firm contracted capacity for the period, expressed as a percentage.

Since assuming operations of its pipeline system, TGS has succeeded in increasing peak-day delivery capability, as reflected in the pipelines' increase in average three-day peak deliveries, from 42.9 MMm<sup>3</sup>/d (1.5 Bcf/d) in 1991, as measured by GdE (no measurement being available for 1992), to 62.7 MMm<sup>3</sup>/d in June 1999.

**Pipeline expansions.** Since assuming commercial operations, TGS has increased its available transportation capacity by 35%, from 42.9 MMm<sup>3</sup>/d (1.5 Bcf/d) to 58 MMm<sup>3</sup>/d (2.0 Bcf/d). To this end, TGS has conducted several "open seasons" designed to provide all potential shippers with the opportunity to secure additional firm transportation capacity.

In 1994, TGS completed its first major expansion, which consisted of the installation of four compressor stations on the Neuba II pipeline rated at approximately 78,000 total HP, thereby increasing transportation capacity from the Neuquén basin to Buenos Aires and Bahía Blanca by 7.5 MMm<sup>3</sup>/d (265 MMcf/d). The expansion was placed in service in two phases in April and July 1994 and cost approximately US\$ 91 million. TGS executed firm transportation contracts for the total additional capacity.

In 1995, the Company completed an expansion project on the General San Martín pipeline, which increased capacity by approximately 1.3 MMm<sup>3</sup>/d (45.9 MMcf/d). The expansion included: (i) the construction of 60 km (37.3 miles) of looping of 30-inch pipe, (ii) modification of 12 compressors to increase compression capacity, and (iii) the addition of a new turbine-driven compressor of 4,700 HP. The total cost of the expansion was approximately US\$ 35 million.

In 1996, TGS concentrated on the removal of bottlenecks in both its Neuba I and Neuba II pipelines. As a result of debottlenecking, capacity increased by 1.0 MMm<sup>3</sup>/d (35.3 MMcf/d) and 0.5 MMm<sup>3</sup>/d (17.6 MMcf/d) on the Neuba II and Neuba I pipelines, respectively. TGS has fully subscribed the increased capacity through long term agreements. Total investment was approximately US\$ 16 million, including the construction of a lateral line of approximately 44 km (27.3 miles), which is jointly owned by the Company and Pampeana, and the automation and upgrading of two compression stations.

In 1997, the Company completed several projects that increased transportation capacity including the construction of a 60 km (37.3 miles) lateral line, jointly owned by TGS and Sur, together with the construction of a 10 km (6.2 miles) 30-inch pipe looping in the San Martín pipeline at a cost of approximately US\$ 12 million. The resulting increased capacity of 0.65 MMm<sup>3</sup>/d (23.0 MMcf/d) was fully subscribed under a long term agreement. Also, in 1997 the Company completed the construction of a 15 km (9.3 miles) 36-inch pipe looping on the Neuba II pipeline at a total cost of approximately US\$ 8 million. All of the additional capacity was fully subscribed under a 0.54 MMm<sup>3</sup>/d (19.1 MMcf/d) long-term agreement, that became effective in 1998.

During 1998 and 1999, the Company spent approximately US\$ 11 million to expand its Cordillerano pipeline through looping and the addition of compression. This investment was included in the determination of the investment factor, which resulted in an increase in TGS's transportation rates. See "Regulatory Framework-Adjustment of Rates".

In 1999, TGS completed an expansion of the Neuba II pipeline, which increased available capacity by 1.4 MMm<sup>3</sup>/d (49.4 MMcf/d). The total investment of this expansion amounted to approximately US\$ 32 million. The expansion consisted of: (i) 60 km (37.3 miles) of 30/36-inch pipes looping, and (ii) an increase of compression capacity by approximately 5,000 HP. The total additional capacity has been fully subscribed under firm long-term transportation agreements partially effective in 1998 and with full effect in 2001. In May 1999, TGS completed an open season which had started in 1998, receiving 2.4 MMm<sup>3</sup>/d (84.8 MMcf/d) in net request for additional transportation services (representing a 4% increase on its current contracted transportation capacity). The request was mainly received from industrial customers. To meet their demand, TGS need to invest approximately US\$ 81 million to expand the San Martín and Neuba II pipelines. The expansion consists of: (i) 200 km (124.3 miles) of 30/36-inch pipes looping, and (ii) an increase of compression capacity by approximately 33,500 HP. As of December 31, 1999, almost 75% of the total investment was completed. Such expansion will be fully in service in 2000 and will not require a tariff increase request to the ENARGAS. Additionally, in 1999, the Company completed a new open season, which resulted in: (i) additional contracted transportation capacity for approximately 0.7 MMm<sup>3</sup>/d (24.7 MMcf/d) requested by industrial customers, effective between October 1999 and the end of 2000, and (ii) an extension of a transportation route requested by a distribution company customer, effective October 1999. The investment related to this expansion amounted approximately to US\$ 3 million and consists of 10 km (6.2 miles) of 30-inch pipes looping in San Martín pipeline.

**Future expansions.** In November 1999, TGS conducted a new open season for firm transportation capacity which resulted in an extension of a transportation route requested by distribution companies, effective June 2000. It is expected that the transportation expansion will require investments of approximately US\$ 10 million on the Neuba II pipeline. Additionally, TGS has recently entered into an agreement with Panamerican Energy and British Gas to jointly construct, operate and maintain a 40 km link pipeline. This link pipeline will connect TGS pipeline system to a new pipeline to be built. This new pipeline is the result of a bidding of the Uruguayan Government to construct a pipeline to Uruguay with an original capacity of 2.5 MMm<sup>3</sup>/d (88.3 MMcf/d), to provide gas mainly to two central power generators and Montevideo city. This pipeline capacity, designed to supply the Uruguay's market potential growth of an estimated gas demand of 5.5 MMm<sup>3</sup>/d (194.2 MMcf/d), could be expanded to 18.5 MMm<sup>3</sup>/d (653.3 MMcf/d) to cover the demand in the south of Brazil. The link pipeline will have an initial transportation capacity of approximately 2 MMm<sup>3</sup>/d, requiring an investment of approximately US\$ 20 million, and is expected to be operational at the beginning of 2001. This represents a concrete step towards accomplishing TGS' growth strategy of accessing to the regional market.

**System improvements.** During the five-year period ended December 31, 1997 and as a part of the five-year mandatory investment program required under its License, TGS made capital expenditures in the aggregate amount of approximately US\$ 172 million to improve the safety and reliability of its pipeline system. These investments included approximately US\$ 34 million for internal and external inspection of approximately 10,000 km (6,217 miles) including a first and, in some cases, a second inspection of TGS's main pipelines. The inspections were performed using the leading technology for detecting pipeline flaws, such as metal loss, out-of-round condition and manufacturing or welding defects and their magnitude and precise location. TGS used the information resulting from the inspection program to establish a maintenance and repair schedule. Based on the results of the inspections, the Company has replaced approximately 304 km (189 miles) of pipelines on its Neuba I, Loop Sur and San Martín pipelines without any significant impact on service, at a cost of approximately US\$ 111 million, including repair costs. In addition, the Company invested approximately US\$ 27 million in other mandatory investments designed to improve the safety and reliability of the system. During the initial five-year period TGS also made capital expenditures of approximately US\$ 54 million in addition to those required under the TGS License. These investments were directed towards the pipeline compression facilities and the enhancement of overall pipeline system safety and reliability.

In 1998 and 1999, the Company made capital expenditures in the amount of US\$ 67.5 million to continue the enhancement of the pipeline system's safety and reliability. This amount included US\$ 40 million of investments contemplated in the determination of the "investment factor" and, accordingly, the Company benefited from an increase in its transportation rates. See "Regulatory Framework-Adjustment of Rates". As part of these investments, the replacement of five compressor units with higher compression power amounted to approximately US\$ 30 million. This replacement, which was terminated in April 1999, represented an increase in compression power of 20,000 HP.

The Company is operating its pipelines in accordance with the Argentine gas transmission safety regulations, which are substantially similar to United States federal regulations. The Company believes that, based on the pipeline inspection reports it has received to date and the pipeline repairs and/or replacements being made to the General San Martín and Neuba I pipelines, the current operation of the pipeline system poses no significant safety risks. However, the Company experienced five ruptures, two in its General San Martín pipeline and three in the Neuba I pipeline. The ruptures caused a brief disruption of services to certain customers. No casualties or significant damage to third parties were experienced as a result of the ruptures. Since the commencement of its operations, in late 1992, the Company implemented measures to ensure that the service was not interrupted in any relevant consumption center. Except for the ruptures described above there has not been any other major safety related incident on the TGS system.

In 1999, TGS made hydrostatic tests on 110 km of the Neuba I pipeline, which suffered three ruptures resulting from Stress Corrosion Cracking. The ruptures did not cause a disruption of services to customers. No casualties or significant damage to third parties were experienced as a result of the ruptures. The hydrostatic test consists of exposing the pipeline to higher pressure than the ordinary operating one. As a consequence of these tests, approximately 1,060 meters of pipeline were replaced.

**System automation.** TGS has improved system automation through a three-part program which includes installation of an electronic flow measurement system ("EFM"), implementation of remote controls at compressor stations and end devices, such as valves, and implementation of dynamic system simulation. The EFM system has been installed at custody transfer points along the system and the data is transmitted to the gas control center in Buenos Aires. The EFM system controls almost all the gas transported along the pipeline, allowing TGS to monitor the flow and pressure of gas along the pipeline in real time. The information provided by the EFM system and the remote compressor controls provide data to the system simulation. The system simulation in turn analyzes the data and assists in optimizing the volume of gas transported through the system. The Company believes that the improved system automation ensures greater control over gas flow and improves TGS's ability to deliver gas more effectively, to provide precise information to customers as to the movement of the gas, to minimize fuel usage and to generally enhance the quality and reliability of the services the Company provides. Currently, TGS remotely operates 14 of its 28 compressor stations.

**Technical Assistance Agreement.** As part of its bid to purchase a 70% interest in the Company from the Argentine government, CIESA was required to have as an investor a company with experience in natural gas transmission that would serve as technical operator. The technical operator for TGS is Enron Pipeline Company Argentina ("Enron Argentina"), an indirect, majority-owned subsidiary of Enron, which operates one of the largest natural gas transmission systems in the world. Enron Argentina provides technical assistance to TGS under a Technical Assistance Agreement, which has an initial term of eight years and is automatically renewable for additional eight-year terms, unless either party elects to terminate. The terms of the Technical Assistance Agreement were set by the Argentine Government as part of the privatization of GdE.

The Technical Assistance Agreement sets out the services to be provided by Enron Argentina to TGS, at the request of TGS's General Director, in return for payment of an annual technical assistance fee equal to the greater of (i) US\$ 3 million or (ii) 7% of the amount obtained after subtracting US\$ 3 million from net income before financial income (expense) and holding gains (losses) and income taxes. The services to be provided by Enron Argentina to TGS under the Technical Assistance Agreement include assisting TGS in the following matters to the extent that they arise in the ordinary course of business: (i) replacement, repair and renovation of facilities and equipment to ensure that the performance of the system is in accordance with international gas transportation industry standards; (ii) preparation of performance evaluations, operating cost analyses, construction assessments and advice related to budget control; (iii) advice regarding safety, reliability and efficiency of system operation and gas industry services; (iv) advice regarding compliance with applicable laws and regulations relating to safety and health, pollution and environmental protection of the system; (v) routine and preventive maintenance of the system; (vi) staff training; (vii) design and implementation of the procedures necessary to accomplish the aforesaid services; and (viii) design and implementation of a management

information and inspection system for all major aspects of natural gas transportation and processing.

## The Argentine Natural Gas Industry

**Historical Background.** Prior to the privatization of GdE, the Argentine natural gas industry was effectively controlled by the Argentine Government. In addition, prior to its privatization, YPF or its predecessors held exclusive rights over the development and production of all new hydrocarbon reserves in Argentina.

In 1992, the Natural Gas Act and Decrees Nos. 1,189/92 and 1,738/92 of the Executive Branch were passed providing for the privatization of GdE. The Natural Gas Act and the related decrees provided for, among other things, the transfer of substantially all of the assets of GdE to two transportation companies and eight distribution companies. The transportation assets were divided into two systems on a broadly geographical basis, the northern and southern trunk pipeline systems, designed to give both systems access to gas sources and to main centers of demand, including the greater Buenos Aires area. As a result of the division, the TGS transportation system is connected to the two distribution systems serving the greater Buenos Aires area, one serving Buenos Aires Province (excluding greater Buenos Aires) and one serving southern Argentina. TGN is connected to five distribution systems serving northern Argentina. TGN is also connected to the distribution systems serving the greater Buenos Aires area and, to a limited extent, the distribution system serving Buenos Aires Province (excluding greater Buenos Aires). In the two instances where TGS and TGN are both directly connected to a distribution system, TGS is the principal supplier of gas transmission services.

The Natural Gas Act and related decrees granted each privatized company a license to operate the transferred assets, established a regulatory framework for the privatized industry based on open, non-discriminatory access, and created ENARGAS to regulate the transportation, distribution, marketing and storage of natural gas. The Natural Gas Act also provided for the regulation of wellhead gas prices in Argentina for an interim period. Prior to deregulation, the regulated price was set at US\$ 0.97/million British thermal units ("MMBtu") at the wellhead, which had been the regulated price since 1991. Pursuant to Decree No. 2,731/93, gas prices were deregulated as of January 1, 1994. Since deregulation average prices have risen by approximately 20% based on 1999 average prices, depending on the basin, the amount of gas and the time of year.

**Demand for Natural Gas.** Natural gas consumption in Argentina has more than tripled since 1980, from approximately 9.3 Bm<sup>3</sup> (328 Bcf) in 1980 to 29.8 Bm<sup>3</sup> (1,052 Bcf) in 1999, representing a compound annual rate of growth in consumption of approximately 6%. According to data published by the Argentine Secretary of Energy, local demand for natural gas is expected to increase at an annual rate of 3.6% through the year 2010 due to the availability of abundant natural gas supplies in Argentina, low prices relative to those for competing energy sources and an increase in gas pipeline capacity. In addition, natural gas has experienced a significant increase in market share in recent years to approximately 45% of total national energy consumption in 1997, almost doubling the share of energy consumption worldwide accounted for by natural gas. Despite the relatively high market share for natural gas in Argentina when compared with other countries, additional market opportunities for natural gas exist in Argentina. For example, according to the Argentine Secretary of Energy, approximately half of residential households currently have no access to natural gas.

The table below sets forth the consumption of natural gas in Argentina by class of user, stated as a percentage of total consumption, for the periods indicated.

	1980	1985	1990	1995	1996	1997	1998	1999 <sup>(1)</sup>
Residential and Commercial	27.3	29.3	27.4	29.2	25.6	25.3	29.7	30.2
Industrial	43.7	38.2	34.4	39.1	35.8	36.5	37.0	32.8
Electric Power Generator	25.3	24.6	29.9	25.4	32.6	31.6	24.9	28.5
Other	3.7	7.9	8.3	6.3	6.0	6.6	8.4	8.5
Total	<b>100</b>							

(1) Based on gas consumption for the period October 1998 – September 1999.

Source: ENARGAS 's 1995, 1996, 1997 and 1998 annual reports and December 1999 monthly report.

The Company believes there will be a significant growth in the use of natural gas throughout the Southern Cone driven by the rapid growth in the electricity demand in Argentina, Brazil, Chile and Uruguay. Due to the significant gas reserves in Argentina and Bolivia within their territories, these countries are becoming major natural gas exporters to Chile, Brazil,

and Uruguay. There are various pipeline construction projects in different stages of development (some of them were concluded during 1999) to connect the electricity demand in Chile, Brazil and Uruguay to the Argentine and Bolivian gas basins. TGS is strategically positioned, being the operator of the General San Martín pipeline which connects the Austral basin gas reserves to the largest population centers of Argentina. Such reserves would become essential to support these export projects. Management believes that TGS will be required to expand the system capacity over the medium and long term if it is to participate in this expected growth in gas demand.

**Gas Supply.** For the most part, Argentina's gas reserves have been originally discovered as a consequence of exploration for oil reserves. There are 19 known sedimentary basins in the country, ten of which are located entirely onshore, six of which are combined onshore/offshore and three of which are entirely offshore. Production is concentrated in five basins: Noroeste in northern Argentina, Neuquén and Cuyo in central Argentina, and Golfo San Jorge and Austral in southern Argentina. Approximately 63% of the gas transported by the TGS system in 1999 originated in the Neuquén basin with the remainder coming primarily from the Austral basin. TGS's pipeline system is connected to the Neuquén, Austral and San Jorge basins. TGS is not connected to the Cuyo or Noroeste basins. According to data published by the Argentine Secretary of Energy, proved gas reserves as of December 31, 1998 from basins to which TGS's pipeline system is connected would last approximately 16 years based on the level of production during 1998.

Set forth in the table below is the location of the principal gas producing basins by province, their proved natural gas reserves estimated as of December 1998, production in 1998 and the calculated reserve life for each basin.

Basin	Location by province	Proved Gas Reserves <sup>(1)(2)</sup>	Production 1998	Reserve Life <sup>(3)</sup>
		MMm <sup>3</sup>	MMm <sup>3</sup>	(years)
Neuquén	Neuquén, Río Negro, La Pampa, Mendoza (south)	357,206	22,379	16.0
Austral	Tierra del Fuego, Santa Cruz (south), and offshore	158,023	8,080	19.6
Golfo San Jorge	Chubut, Santa Cruz (north)	17,105	2,676	6.4
Cuyo	Mendoza (north)	821	91	9.0
Noroeste	Salta, Jujuy, Formosa	153,429	5,497	27.9
Total		<b>686,584</b>	<b>38,723</b>	<b>15.8</b>

<sup>(1)</sup> Estimated as of December 31, 1998. There are numerous uncertainties inherent in estimating quantities of proved reserves. The accuracy of any reserve estimate is a function of the quality of available data and engineering and geological interpretation and judgment. Results of drilling, testing and production after the date of the estimate may require substantial upward or downward revisions. Accordingly, the reserve estimates could be materially different from the quantity of gas that ultimately will be recovered.

<sup>(2)</sup> Reserve figures do not include significant reserves located in certain Bolivian basins to which TGN is connected.

<sup>(3)</sup> Weighted average reserve life for all basins, at 1998 production levels.

Source: Gas & Gas Magazine

**Neuquén Basin.** The largest of the gas basins and the major source of gas supply for the TGS system is the Neuquén basin, located in west central Argentina. The TGN system also accesses the Neuquén basin. Of the transported gas coming from the Neuquén Basin approximately 60% was transported by TGS and approximately 40% by TGN.

**Austral and Golfo San Jorge Basins.** Natural gas provided by this basins, located in the extreme southern region and southern portion of Argentina, was transported mainly by TGS (Sur also transports gas through regional pipelines). In the Austral basin, exploration has centered in and around the basin's existing gas fields and on other fields located offshore. The Golfo San Jorge basin is primarily an oil-producing basin.

## Regulatory Framework

**Industry Structure.** The Natural Gas Act, together with Decree No. 1,738/92, other regulatory decrees, *The Pliego de Bases y Condiciones para la Privatización de Gas del Estado S.E.* ("the Pliego"), the transfer agreements and the licenses of the newly privatized companies establish the legal framework for the transportation and distribution of gas in Argentina. Law No. 17,319 (the "Hydrocarbons Law") regulates the upstream gas industry, under a competitive and partially deregulated system.

Natural gas transportation and distribution companies operate in an "open access", non discriminatory environment under which producers and certain third parties, including distributors, are entitled to equal and open access to the transportation

pipelines and distribution system in accordance with the Natural Gas Act, applicable regulations and the licenses of the privatized companies. In addition, a regime of concessions under the Hydrocarbons Law is available to holders of exploitation concessions to transport their own gas production.

The Natural Gas Act prohibits gas transportation companies from also being merchants in natural gas. Also, (i) gas producers, storage companies, distributors, and consumers who contract directly with producers may not own a controlling interest (as defined in the Natural Gas Act) in a transportation company, (ii) gas producers, storage companies and transporters may not own a controlling interest in a distribution company, and (iii) merchants in natural gas may not own a controlling interest in a transportation or distribution company.

Contracts between affiliated companies engaged in different stages in the natural gas industry must be approved by ENARGAS. ENARGAS may reject these contracts if it determines that they were not entered into on an arms-length basis.

ENARGAS, which was established by the Natural Gas Act, is an autonomous entity responsible for enforcing the provisions of the Natural Gas Act, applicable regulations and the licenses of the privatized companies. ENARGAS is governed by a board of directors composed of five full time directors who are appointed by the Executive Branch subject to confirmation by the Congress. ENARGAS, which operates within the purview of the Ministry of Economy and Public Works and Services, has broad authority to regulate the operations of the transportation and distribution companies, including the ability to set rates. ENARGAS has its own budget which must be included in the Argentine National Budget and submitted to Congress for approval. ENARGAS is funded principally by annual control and inspection fees that are levied on regulated entities in an amount equal to the approved budget, net of collected penalties, allocated proportionately to each regulated entity based on their respective gross regulated revenues, excluding natural gas purchase and transportation costs in the case of distribution companies. ENARGAS also collects the fines imposed for violations of the Natural Gas Act and each company's license.

In accordance with the Natural Gas Act, the Decree No. 1,738/92 and the License provisions, the ENARGAS was required to issue accounting standards based on Argentine GAAP to be applied to the gas transportation and distribution companies (the Gas Companies) for regulatory purposes within the 12-month period after the privatization. In late 1999, ENARGAS prepared an initial draft which is currently being analyzed among the Gas Companies. In such draft, ENARGAS is also proposing useful lives to be assigned to the gas transportation and distribution assets. This preliminary useful lives proposal is related to the ENARGAS' request mentioned in Notes 2.h. and 14 to TGS' financial statements included elsewhere herein and in the "Management's Discussion and Analysis of Financial Condition and Results of Operations". If TGS were finally obliged to change the reestimation of the useful life mentioned elsewhere herein, the Company believes it would modify the depreciation charge prospectively and therefore the Company does not expect any significant impact on its financial condition and results of operations for the year ended December 31, 1999.

***The TGS License.*** The TGS License authorizes it to provide the public service of gas transportation through the exclusive utilization of the southern gas transportation system. The TGS License does not grant an exclusive right to TGS to transport gas in a specified geographical area and licenses may be granted to others for the provision of gas transportation services in the same geographical area. TGN operates the northern gas transportation system under a license containing substantially similar terms to those described below and elsewhere herein.

The TGS License has been granted for an original term of 35 years. However, the Natural Gas Act provides that TGS may apply to ENARGAS for a renewal of the TGS License for an additional ten-year term. ENARGAS is required at that time to evaluate TGS's performance and make a recommendation to the Executive Branch. If ENARGAS determines that TGS is in substantial compliance with all its obligations arising under the Natural Gas Act, related regulations and the TGS License, the renewal must be granted by the Executive Branch. ENARGAS would have the burden of proving that TGS had not complied with the obligations described above and, therefore, should not be granted a renewal. At the end of the 35-year or 45-year term, as the case may be, the Natural Gas Act requires that a new competitive tender be held for the license, in which TGS would have the option, if it has complied substantially with its obligations described above, to match the best bid offered to the Argentine Government by any third party. To the extent that TGS were found not to have complied with the obligations described above or chose not to seek renewal of its License, the Company would be entitled to certain specified compensation. See "Certain Restrictions with Respect to Essential Assets" below.

The TGS License also specifies certain other rights and obligations of TGS relating to the service which it provides. These include:

- operating and safety standards;
- terms of service, including general service conditions such as specifications regarding the quality of gas transported, major equipment requirements, invoicing and payment procedures, imbalances and penalties, and guidelines for dispatch management;
- contract requirements, including the basis for the provision of service, e.g., “firm” or “interruptible”;
- mandatory capital investments to be made over the first five years of the license term; and
- applicable rates based on the type of transportation service and the area serviced.

The mandatory five-year investment plan for the years 1993-1997, which was approved by ENARGAS in 1999, required the Company to invest on its natural gas pipeline system a total of US\$ 153 million representing US\$ 30.6 million per year beginning in 1993. This mandatory investment plan was related to the operational capability and public safety of the pipeline system and included, among others, cathodic protection, internal inspection and pipeline replacement and coating.

The TGS License establishes a system of penalties in the event of a breach by TGS of its obligations thereunder, including warnings, fines and revocation of the License. These penalties may be assessed by ENARGAS based, among other considerations, upon the severity of the breach or its effect on the public interest. Fines of up to US\$ 500,000 may be levied for persistent breaches. Revocation of the TGS License may only be declared by the Executive Branch upon the recommendation of ENARGAS. The TGS License specifies several grounds for revocation, including the following:

- repeated failure to comply with the obligations of the License and failure to remedy a significant breach of an obligation in accordance with specified procedures;
- total or partial interruption of the service for reasons attributable to the Company, affecting completely or partially transportation capacity during the periods stipulated in the License;
- sale, assignment or transfer of the Company's essential assets or the placing of encumbrances thereon, without ENARGAS's prior authorization, unless such encumbrances serve to finance extensions and improvements to the gas pipeline system;
- bankruptcy, dissolution or liquidation of the Company;
- ceasing and abandoning the provision of the licensed service, attempting to assign or unilaterally transfer the License in full or in part without the prior authorization of ENARGAS, or giving up the License, other than in the cases permitted therein; and
- transfer of the Technical Assistance Agreement, or delegation of the functions granted in such contract, without the prior authorization of ENARGAS, or the termination of such Agreement without regulatory approval of a new contract.

The TGS License also prohibits the Company from assuming debts of CIESA, or from granting credit to, creating security interests in favor of, or granting any other benefit to, creditors of CIESA.

The TGS License may not be amended without the consent of TGS. However, ENARGAS may alter the terms of service annexed to the License. If any such alteration were to have an economic effect on TGS, ENARGAS could modify TGS rates to compensate for such effect or TGS could request a change in the applicable rates.

**Regulation of Transportation Rates - Actual Rates.** The gas transportation rates established under each transportation company's license are based in U.S. dollars and converted into pesos at the time of billing pursuant to the terms of such license at the rate of exchange as provided in the Convertibility Law, as it may have been amended at the time of billing. The current rates are fixed for the five-year period ending December 31, 2002 and are subject to the adjustment described below.

The transportation rate for firm transportation services consists of a capacity reservation charge and is expressed as a maximum monthly charge based on the cubic meters per day of reserved transportation capacity. The rate for interruptible transportation service, which is expressed as a minimum (from which no discounts are permitted) and a maximum rate per 1,000 m<sup>3</sup> of natural gas transported, is equivalent to the unit rate of the reservation charge for the firm service based on a load factor of 100%. For both firm and interruptible transportation services, customers are obligated to provide a natural gas in-kind allowance, expressed as a maximum percentage of gas received, equivalent to the gas consumed or lost in rendering the transportation service. The rates for all services reflect the rate zone(s) traversed from the point of receipt to the point of delivery.

The table below sets out TGS's firm and interruptible rates by pipeline and zones, in effect since January 1, 2000:

Rate Zones		Firm	Interruptible	Compression Fuel and Losses <sup>(3)</sup> (%)
		Reservation Charge <sup>(1)</sup> (US\$/m <sup>3</sup> /d)	Minimum Charge <sup>(2)</sup> (US\$/1000 m <sup>3</sup> /d)	
Receipt	Delivery			
From Tierra del Fuego to:	Tierra del Fuego	0.076	2.541	0.49
	Santa Cruz Sur	0.154	5.123	0.98
	Chubut Sur	0.392	13.068	3.38
	Buenos Aires Sur	0.462	15.396	5.60
	Bahía Blanca	0.707	23.583	8.40
	La Pampa Norte	0.705	23.500	8.60
	Buenos Aires	0.828	27.593	10.35
	Greater Buenos Aires	0.929	30.959	11.27
From Santa Cruz Sur to:	Santa Cruz Sur	0.077	2.575	0.49
	Chubut Sur	0.315	10.508	2.89
	Buenos Aires Sur	0.385	12.841	5.11
	Bahía Blanca	0.632	21.071	7.91
	La Pampa Norte	0.632	21.067	8.11
	Buenos Aires	0.753	25.093	9.86
	Greater Buenos Aires	0.854	28.470	10.78
From Chubut to:	Chubut Sur	0.077	2.554	0.49
	Buenos Aires Sur	0.144	4.788	2.71
	Bahía Blanca	0.383	12.768	5.51
	La Pampa Norte	0.402	13.406	5.71
	Buenos Aires	0.498	16.598	7.46
	Greater Buenos Aires	0.594	19.790	8.38
From Neuquén to:	Neuquén	0.068	2.334	0.49
	Bahía Blanca	0.331	11.018	2.80
	La Pampa Norte	0.356	11.868	3.15
	Buenos Aires	0.448	14.923	3.91
	Greater Buenos Aires	0.548	18.315	4.86

(1) Monthly charge for every cubic meter per day of reserved transportation capacity.

(2) Minimum charge equal to the unit rate of the firm reservation charge at a 100% load factor.

(3) Maximum percentage of total transported gas which customers are required to replace in-kind to make up for gas used by the Company for compressor fuel or losses in rendering transportation services.

Source: ENARGAS Resolution No. 1470/00 (gross receipts tax is not included in such transportation rates).

**Adjustment of Rates.** Under the TGS License, the Company is permitted to adjust rates (i) semi-annually to reflect changes in the US PPI, and (ii) every five years in accordance with efficiency and investment factors to be determined by ENARGAS. In addition, subject to ENARGAS's approval, rates may be adjusted from time to time to reflect cost variations resulting from changes in the tax regulations (other than income tax) applicable to the Company, and for objective, justifiable and non-recurring circumstances.

The Natural Gas Act requires that in formulating the rules that apply to the setting of future rates, ENARGAS must provide the transportation companies with (i) an opportunity to collect revenues sufficient to recover all proper operating costs reasonably applicable to service, taxes and depreciation, and (ii) a reasonable rate of return, determined in relation to the rate of return of businesses having comparable risk, and shall take into account the degree of efficiency achieved and the performance of the company in providing the service. No assurances can be given that the rules to be promulgated by ENARGAS will result in rates that will enable the Company to achieve specific earnings levels in the future.

The rate-setting methodology contemplated by the Natural Gas Act and the TGS License is the “price-cap with periodic review” model. Under this model, rates may be adjusted by an efficiency and an investment factor. Based upon the regulatory theory those rates should provide a reasonable return and that the benefit of increased efficiency should be shared by the consumer and the transporter, the inclusion of an efficiency factor results in a decrease in rates as the transporter lowers costs through increased efficiency. Notwithstanding this, the inclusion of the efficiency factor in the pricing system provides the transporter with an incentive to cut costs because the price is established in advance for the period up to the next five-year revision, and does not discount for efficiencies made during the period. The adjustment to account for efficiencies is proposed by ENARGAS based on specific plans for efficiency improvements, taking into account both the expected cost savings and the investment required for the implementation of such plans.

The inclusion of the investment factor in the formula specified in the TGS License is intended to permit an increase in the rates at the time of their adjustment to compensate the Company for certain investments to be made during the relevant five-year period. The investments contemplated by the investment factor are those designed to improve the efficiency, safety or reliability of the system and to expand the system, and may either be required by ENARGAS to be made or may initially be proposed to be undertaken by the Company. In exceptional cases, the Company may also petition ENARGAS at any time for a rate adjustment relating to proposed investments to expand system capacity when the resulting costs cannot be recovered with the existing rate.

If TGS does not agree on the efficiency or investment factors established by ENARGAS, or on the terms of the investment program established by ENARGAS, the factors established by ENARGAS will be applied but TGS may seek review of ENARGAS's action by administrative or judicial procedures.

ENARGAS is responsible for determining the rates that are to be effective during each succeeding five-year period following the initial five-year period ended December 1997. In 1996, ENARGAS set the weighed average cost of capital to be used for the determination of the efficiency and investment factors at 11.3% per annum, net of future inflation. As a result of the first general rate review process which ended in December 1997, the Company's transportation rates suffered an up front one-time decrease of 6.5% effective January 1, 1998, based on the application of the efficiency factor, representing a decrease of approximately Ps. 24 million in 1998 net revenues. In connection with the investment factor, ENARGAS approved the application of periodic increases through January 2002 to the Company's tariffs resulting in a total weighted average of 2.6% as of that date to compensate the Company for approximately US\$ 70 million in investments. These investments which TGS intends but is not required to undertake, principally include the modifications to the Buenos Aires high-pressure ring, the expansion of the Cordillerano Pipeline in Western Argentina, and enhancements to the General San Martín pipeline in preparation for future expansions. As part of the 2.6% increase, ENARGAS approved a weighted average increase in tariffs of 0.24%, 1.36%, 0.54% and 0.15% effective as of July 1, 1998, January 1, 1999, July 1, 1999 and January 1, 2000, respectively.

In January 2000, ENARGAS, through its resolution N° 1,470, and with the previous consent of the gas transportation and distribution companies, approved the postponement of the PPI adjustment, (which corresponds to the first semester of the year 2000) until July 1, 2000. The PPI adjustment represents an increase to the tariff rates of 3.78%. Such extraordinary and one-time postponement implies a financing and subsequent recovery of the adjustment. Also, as part of such resolution, ENARGAS set up a methodology to bill the revenue impact of the adjustment to be accrued during the first half of 2000.

**Certain Restrictions with Respect to Essential Assets.** A substantial portion of the assets transferred by GdE has been defined in the TGS License as essential for the performance of the licensed service. Pursuant to the TGS License, the Company is required to segregate and maintain the essential assets, together with any future improvements thereon, in accordance with certain standards defined in the License.

The Company may not for any reason dispose of, encumber, lease, sublease or lend essential assets for purposes other than provision of the licensed service without ENARGAS's prior authorization. Any extensions or improvements that the Company may make to the gas pipeline system may only be encumbered to secure loans that have a term of more than one year to finance such extensions or improvements.

Upon expiration of the License, the Company will be required to transfer to the Argentine Federal Government or its designee, the essential assets specified in the License as of the expiration date, free of any debt, encumbrance or attachment, receiving compensation equal to the lower of the following two amounts:

- the net book value of the essential assets determined on the basis of the price paid by CIESA for shares of common stock of TGS plus the original cost of subsequent investments carried in US dollars in each case adjusted by the PPI, net of accumulated depreciation in accordance with the calculation rules to be determined by ENARGAS.
- the net proceeds of a new competitive bidding.

Under Argentine law, an Argentine court would not permit the enforcement of a judgment on any property of TGS located in Argentina which is determined by the courts to provide essential public services. This may adversely affect the ability of a creditor to realize a judgment against the assets of TGS.

The Transfer Agreement allocates to GdE or the Company, respectively, liabilities for damages caused by or arising from the GdE assets transferred according to whether the damages arise from the operation of the assets prior to or following the Takeover Date. Also, pursuant to the Agreement, the Company is responsible for any defects in title to such assets, although any such defects are not expected to be material. The Transfer Agreement further provided that GdE is responsible for five years from the transfer date until December 1997, for the registration of easements related to the system which have not been properly recorded and for the payment to property owners of any royalties or fees in respect thereof. From 1998, the Company is responsible for properly recording any remaining easement agreement and for making payments of royalties or fees related to such easements. See "Legal and Regulatory Proceedings".

## **GAS PROCESSING AND OTHER SERVICES - NON-REGULATED BUSINESS**

TGS's gas processing activities and other services are not subject to regulation by ENARGAS. Processing and other services revenues accounted for approximately 18% of net revenues in 1999 and 12% in 1998 and 1997.

### **Gas Processing**

TGS's gas processing activities are conducted at its Cerri Complex. The Cerri Complex is located near the city of Bahía Blanca and is connected to each of TGS's main pipelines.

The annual sales for the Cerri Complex for 1999, 1998 and 1997 in short tons were as follows:

	<u>1999</u>	<u>1998</u>	<u>1997</u>
Ethane .....	377,711	327,578	332,149
Propane .....	396,390	298,788	336,317
Butane .....	286,204	213,571	220,413
Natural gasoline .....	129,288	91,457	93,816
Total .....	<u>1,189,593</u>	<u>931,394</u>	<u>982,695</u>

Sales for 1999 were higher than for 1998 and 1997, mainly as a consequence of the start up of the Cerri Complex expansion. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Results of Operations".

Propane, butane and natural gasoline are transported via two eight-inch pipelines to the loading terminal at Puerto Galván. Ethane is piped via an eight-inch pipeline to Petroquímica Bahía Blanca's ("PBB") olefins plants which is the sole outlet for ethane from the Cerri Complex. The Cerri Complex extracts ethane only when it can be accepted at PBB. Otherwise, any ethane extracted is reinjected into the pipeline.

In December 1998, the Company completed the expansion of the gas processing and storage capacity at the Cerri Complex. The expansion, with a construction cost of approximately US\$ 76 million, increased processing capacity by 13 MMm<sup>3</sup>/d (0.46 Bcf/d), or 43%, and consisted of the construction of a new liquids extraction module, the upgrading of the existing turbo compressors and the construction of two refrigerated storage tanks with a combined capacity of 45,000 m<sup>3</sup>. As a result of this increase in processing capacity, TGS has been able to secure additional gas volumes for processing and to enter into agreements with: (i) Petróleos Brasileiros S.A. ("Petrobrás") for the sale of propane, butane and natural gasoline effective from such expansion start-up through December 2000 (See "Competition") and (ii) local LPG marketers.

TGS currently processes natural gas principally for the accounts of YPF, MetroGas, Pampeana, BAN, PC and Total Austral. The agreement with PC was entered into to partially guarantee the processing of gas volumes by the expanded capacity. The processing agreement with YPF provides for, among other things, a fixed charge per metric ton of liquids produced. Under the terms and conditions of the agreement, YPF has processing rights for up to the first 16 MMm<sup>3</sup>/d (565 MMcf/d) through December 31, 2000 and is required to make in-kind deliveries of additional gas to replace its attributable share of the natural gas shrinkage, fuel and losses associated with the extraction of liquids from the gas. The agreement also provides for the processing of a minimum of 8 MMm<sup>3</sup>/d (283 MMcf/d) from January 1, 2001 through expiration on December 31, 2002 at a fixed charge per metric ton of liquids produced. Gross revenues derived from gas processing for the account of YPF amounted to Ps. 22.2 million in 1999, representing approximately 35% of TGS's gas processing revenues.

The processing agreements with MetroGas, Pampeana, BAN, PC and Total Austral provide for, among other things, a charge equal to a portion of the collected revenues from the sale of the liquids extracted and marketed by TGS for the account of the five companies. Sales of such liquids by TGS are principally made to liquids distributors of butane and propane at prevailing prices in the local market. The natural gasoline is sold to refiners and marketers of gasoline at prevailing prices in the local or external market. The ethane is sold to PBB at prices stipulated in the agreement. Under the terms and conditions of the agreements, MetroGas, Pampeana, BAN, PC and Total Austral have processing rights for the capacity available at the Complex not required to service the YPF agreement. Like YPF, MetroGas, Pampeana, BAN, PC and Total Austral are required to make in-kind deliveries of additional gas to replace their attributable share of the natural gas shrinkage, fuel and losses associated with the extraction of liquids from the gas. The agreements with both MetroGas and Pampeana will expire at the beginning of the year 2001, the ones with BAN and Total Austral at the end of the year 2000 and the one with PC will finish at the beginning of the year 2005.

TGS has recently entered into an agreement with the joint venture formed with Quintana Petroleum Co. and other companies, to process 2.4 MMm<sup>3</sup>/d (85 MMcf/d) from the beginning of 2000 to the end of 2007. The processing agreement provides a fixed charge per metric ton of liquids produced and commercialized.

## **Other Services**

TGS's other services are basically activities upstream of TGS's mainline gas transportation. These upstream activities consist of gas treatment at the wellhead which include the separation and removal of impurities such as water, carbon dioxide and sulfur from the natural gas stream. Small diameter pipes from the wellheads form a network, or gathering system, carrying the gas stream to larger pipelines where field compression is sometimes needed to inject the gas into the Company's large diameter gas pipelines. In addition, the Company also provides services related to pipeline construction, inspection and maintenance.

In connection with the development of the upstream business, in late December 1998, TGS closed an agreement with PC to provide the services of compression and treatment of the natural gas coming from the Río Neuquén gas field from 1999 to 2017. In order to render this service, TGS acquired from PC the compression and treatment plant located in that gas field, with a maximum capacity of 2.4 MMm<sup>3</sup>/d (74.16 Mcf/d). TGS paid for the plant US\$ 35 million and charges a monthly fee to PC in dollars for the rendered services. Annual revenues during the first five years are expected to be approximately US\$ 10 million.

Gross revenues derived from other services for the year ended December 31, 1999 amounted to Ps. 14.7 million.

## COMPETITION

The Company's gas transportation business, which provides an essential service in Argentina, faces only limited direct competition. Although there are no regulatory limitations on entry into the business of providing gas transportation services in Argentina, the construction of a competing pipeline system would require substantial capital investment and the approval of ENARGAS. Moreover, as a practical matter, a direct competitor would have to enter into agreements with distribution companies or end users to transport a sufficient quantity of gas to justify the capital investment. In view of the Company's current firm transportation contracts with its distribution company customers, and the other characteristics of the markets in which the Company operates, management believes that it would be very difficult for a new entrant to the transportation market to pose a significant competitive threat to the Company, at least in the short to intermediate term. In the longer term, the ability of new entrants to successfully penetrate TGS's market would depend on a favorable regulatory climate, an increasing and unsatisfied demand for gas by end users, and sufficient investment in downstream facilities to accommodate increased delivery capacity from the transportation systems.

On a day-to-day basis, the Company competes with TGN, to a limited extent, for interruptible transportation services and from time-to-time for new firm transportation service made available as a result of expansion projects being undertaken by each of the two companies for service to the distribution companies to which both the Company and TGN are either directly or indirectly connected (Pampeana, MetroGas and BAN). TGS and TGN compete directly for the transportation of gas from the Neuquén basin to the greater Buenos Aires area. Interruptible transportation service represented only 2% of the Company's regulated net revenues for 1999. The relative volumes of such service will depend principally on the specific arrangements between buyers and sellers of gas between such areas, the perceived quality of service offered by the competing companies, and the applicable rate for each company. The following chart shows the current contracted capacity by Pampeana, Metrogas and BAN from the Neuquén basin with TGS and TGN in MMm3/d:

	TGS	TGN
Pampeana .....	7,360	250
MetroGas.....	13,740	970
BAN.....	7,229	4,305

ENARGAS has issued rules establishing a methodology to govern the brokering of excess capacity among the distribution companies and other transporters of natural gas, which has been effective since mid April 1997. The system is administered by TGS and TGN. To the extent that such capacity brokerage results in more efficient use of contracted firm capacity, the demand for interruptible transportation services by TGS and TGN customers could decrease.

Gas transportation companies should not be directly affected by changes in gas prices resulting from deregulation, since they neither buy nor sell gas commercially. However, competition in gas markets may affect both TGS and TGN to the extent that the gas basins which they service suffer from a loss of demand as a result of price competition with gas from other basins. This may affect the volume of gas transported from particular gas producing regions. Currently, the city gate price of gas (well-head cost plus transportation cost), originated from Argentine gas basins is approximately Ps. 2.1 per MM of BTU at the Greater Buenos Aires high-pressure ring (delivery points for the greater consumption area in Argentina).

The cost of gas relative to competing fuels may also affect the demand for transportation services in the long term. The delivery cost of gas to end users in Argentina, based on energy content, is currently lower than that of alternative sources of fuel, except for hydroelectric power and fuel oil (for certain periods).

Since the generation of hydroelectricity is the lowest cost source of electricity in Argentina, a substantial increase in the availability of hydroelectricity would displace a significant amount of electricity generated by gas-fired power plants in TGS service territory, thereby causing a decrease in gas usage. This could: (i) reduce demand for interruptible gas transportation, and (ii) prompt the exercise of step-down rights in firm contracted capacity by TGS's customers. The

Yacyretá hydroelectric project in northeastern Argentina, with a projected annual generation capacity of 19,000 GW/h and with twenty turbines on-line, was completed in 1998. Based on information provided by *Compañía Administradora del Mercado Mayorista Eléctrico S.A. ("CAMMESA")*, by October 1999 Yacyretá supplied approximately 15% of the total energy generation in Argentina and more than 35% of total generated hydroelectricity in Argentina.

In addition, Transener S.A. (a company holding an energy transmission license covering the area from the Comahue region to the greater Buenos Aires area) successfully bid for the construction, operation and maintenance of 1,300 Km (812 miles) /550 kw line for energy transmission line. The new line started operating in December 1999. The Company expects this additional energy transmission line will not have a significant negative impact on the volumes of gas transported.

YPF, (which as of December 31, 1999, accounted for approximately 35% of TGS' gas processing gross revenues) together with Petrobrás and Dow Chemical, formed *Compañía MEGA S.A.*, which is building and will operate a gas processing plant with a capacity of approximately 36 MMm<sup>3</sup>/d (1.3 Bcf/d). Operations are expected to start by the end of 2000. *Compañía MEGA S.A.* project, as well as any other project that eventually may be developed upstream of the Cerri Complex, might adversely affect TGS' revenues from gas processing and the other services business. To minimize the revenue impact of any project developed upstream of the Cerri Complex, TGS intends to work together with gas producers to design alternatives to guarantee both the volume and richness of the gas to be processed at the Complex. In addition, the Company's management anticipates that future expansions on the pipeline system will provide new opportunities in the gas processing business and lead to related increases in revenues from its transportation and processing businesses.

## ENVIRONMENTAL MATTERS

TGS's management believes that the Company's current operations are in substantial compliance with applicable laws and regulations relating to the protection of the environment. TGS's environmental policy is designed to comply with Argentine laws relating to hazardous waste and air quality. Under these laws, the principal hazardous substances generated by TGS consist of discarded casing oil, and those parts of the compressor station entry filters which are soaked in hydrocarbons.

TGS has implemented a policy of reducing and treating hazardous substances. Consequently, during 1995 the Company completed a study of all the emissions produced by TGS, including gaseous, liquid and solid emissions, with the objective of making a quantitative and qualitative evaluation. The study covered all the compressor plants and maintenance bases, as well as the Cerri Complex, and extended along nearly 6,000 km (3,728 miles) of gas pipeline. Based on the results of the study, minor farm land restoration was required, as well as construction of drainage systems and the installation of incinerators for the hazardous substances. The Company has established an environmental and industrial security investment plan for the period 2000-2002 with a budget of approximately US\$ 7.3 million.

TGS' policy in connection with environmental affairs and industrial security is based on the Company's commitment to provide gas transportation and other related services observing the following principles:

- i. Continuous improvement in operating standards to avoid accidents and pollution.
- ii. Compliance with provisions contained in the current legislation and procedures adopted by the Company.
- iii. Establishment of annual goals and objectives in accordance with this policy and the Company's vision, mission and values.
- iv. Personnel training in accordance with the responsibility and the risks involved in each job.

In October, 1998, TGS obtained the Environmental Management System Certification, in accordance with the international standards ISO 14001 standards.

## EMPLOYEES AND LABOR RELATIONS

On December 28, 1992, 1,334 employees were transferred to TGS from GdE. In January 1993, the Company launched a voluntary retirement plan under which 463 employees elected to accept early retirement at a cost of approximately Ps. 12.1 million.

As of December 31, 1999, TGS employed 648 employees located in seven provinces of the country (Buenos Aires, La Pampa, Río Negro, Chubut, Neuquén, Santa Cruz and Tierra del Fuego) and the City of Buenos Aires. More than 50% of TGS employees have technical or professional backgrounds.

The following table sets out the number of employees according to department as of December 31, 1999:

<u>Department</u>	<u>Number of Employees</u>
General .....	3
Administration and Finance .....	81
Engineering .....	14
Human Resources and Public Affairs.....	15
Planning and Project Evaluation .....	5
Legal Affairs.....	8
Regulatory Affairs and Tariffs.....	2
Marketing .....	29
Operations .....	491
Total .....	648

At December 28, 1992, all personnel transferred from GdE to TGS were affiliated with unions (three national and five provincial/regional unions). By April 1993, 70% of TGS personnel had withdrawn from union membership. The remaining 30% were affiliated with a national union, the *Federación Argentina de Trabajadores de la Industria del Gas Natural y Afines* (the "Federation") and with a regional union. TGS has signed collective bargain agreements with both unions. Currently, approximately 7% of the TGS workforce is unionized. The Company has not experienced any conflict with the Federation and considers relations with its employees to be good.

## INSURANCE

TGS maintains insurance, subject to deductibles, against third party liability, against business interruption and against damage to its pipeline assets which pass under rivers or other bodies of water, which it believes is commensurate with standards for international natural gas transportation companies. The terms of the policies related to the regulatory assets have been approved by ENARGAS. In addition, in 1996, TGS acquired an insurance coverage for Directors and Officers. Such coverage is common practice among public companies who seek protection against shareholders' and other parties' claims.

## ITEM 2. DESCRIPTION OF PROPERTY

### Gas Transportation

The principal components of the pipeline system operated by TGS are as follows:

*Pipelines.* The 6,987 km (4,336 miles) natural gas transportation system owned and operated by TGS consists primarily of large diameter, high pressure pipelines intended for the transportation of large gas volumes at a pressure of approximately 60-70 kg/cm<sup>2</sup>. Line valves are installed on the pipeline at regular intervals, permitting sections of the pipeline to be isolated for maintenance and repair work. Gas flow regulating and measurement facilities are also located at various points on the system to regulate gas pressures and volumes. In addition a cathodic protection system has been installed to

protect the pipeline from corrosion and significantly reduce metal loss. All of the pipelines are located underground or underwater.

*Maintenance bases.* Maintenance bases are located adjacent to the gas pipeline system in order to maintain the pipeline and related surface facilities, and to handle emergency situations which may arise. Personnel at these bases periodically examine the pipelines to verify their condition, and inspect and lubricate pipeline valves. Personnel at the bases also carry out a cathodic protection system to ensure that adequate anti-corrosion systems are in place and functioning properly. They also maintain and verify the accuracy of measurement instruments to ensure that these are functioning within appropriate industry standards and in accordance with the specifications contained in TGS service regulations. TGS has determined that it can more effectively maintain the pipeline at a lower cost by outsourcing non-critical maintenance functions and reducing the number of maintenance bases. The Company has reduced the number of maintenance bases from 11 to 8. In addition, the Company has consolidated the operations of some maintenance bases with those of the compressor plants.

*Compressor plants.* Compressor plants along the pipelines recompress the gas volumes transported in order to restore pressure to optimal operational levels, thereby ensuring maximum use of capacity as well as efficient and safe delivery. Compressor plants are spaced along the pipelines at various points (between 100 and 200 km) depending upon certain technical characteristics of the pipelines and the required pressure for transport. Compressor plants include turbine-driven compressors or motor-driven compressors which use natural gas as fuel, together with electric power generators to supply the complementary electrical equipment (control and measurement devices, pumping, lighting, communications equipment, etc.).

TGS transports gas through four major pipeline segments: General San Martín, Neuba I, Neuba II and Loop Sur, as well as several smaller gas pipelines. Information with respect to certain aspects of TGS's main gas pipelines is set out in the table below:

Major Pipeline	Length (km)	Diameter (inches)	Maximum Pressure (kg/cm <sup>2</sup> )	Compressor Units	Operative Compressor Plants	HP Output	Current Delivery Capacity	
							MMm <sup>3</sup> /d	MMcf/d
General San Martín	3,192	30	60	48	15	343,230	17.5	618.0
Neuba I/Loop Sur	1,203	24/30	60	12	4	54,200	11.6	409.6
Neuba II	1,334	30/36	70	15	6	123,000	28.9	1,020.6
Other <sup>(1)</sup>	1,258	Various	Various	6	3	7,500	--	--
	6,987			81	28	527,930	58.0	2,048.2

(1) Includes 310 km (193 miles) of transfer pipelines throughout the pipeline system, as well as the Cordillerano pipeline, with a length of 244 km (152 miles).

*General San Martín.* This pipeline was built in three stages, completed in 1965, 1973 and 1978, and transports gas from the extreme southern portion of Argentina to the greater Buenos Aires area in east central Argentina. It originates in San Sebastián (Tierra del Fuego), passes through the Straits of Magallanes and the Provinces of Santa Cruz, Chubut, Río Negro and Buenos Aires (including the Cerri Complex located near the city of Bahía Blanca in central Argentina), and terminates at the high pressure transmission ring around the city of Buenos Aires. The pipeline receives natural gas from the Austral basin in the extreme south at Tierra del Fuego, from the same basin further north at El Cóndor and Cerro Redondo, in the Province of Santa Cruz and from the San Jorge basin in northern Santa Cruz and southern Chubut provinces. The pipeline serves principally the districts and cities of Buenos Aires, La Plata, Mar del Plata, Bahía Blanca and Comodoro Rivadavia.

*Neuba I (Sierra Barrosa-Bahía Blanca).* Neuba I was built in 1970 and is one of TGS's two main pipelines serving its principal source of gas supply, the Neuquén basin. The pipeline originates in west-central Argentina at Sierra Barrosa (Province of Neuquén), passes through the provinces of Río Negro, La Pampa and Buenos Aires, and terminates at the Cerri Complex. This pipeline transports the gas received from the Neuquén basin, particularly from the Sierra Barrosa, Charco Bayo, El Medanito, Fernández Oro, Lindero Atravesado, Centenario, Río Neuquén and Loma de la Lata gas fields. The gas delivered from Neuba I is subsequently compressed and injected into the Loop Sur and the General San Martín pipelines for transportation north to the greater Buenos Aires area.

*Loop Sur.* This gas pipeline was built in 1972 as an extension of Neuba I and runs parallel to a portion of the General San Martín gas pipeline. Located in the province of Buenos Aires, it transports gas from the terminus of Neuba I at the Cerri Complex at Bahía Blanca and terminates at the high pressure transmission ring around Buenos Aires, which is also

operated by TGS. The gas delivered by this gas pipeline constitutes a portion of the gas supply for the greater Buenos Aires area. Loop Sur is also connected to the TGN system and allows TGS to deliver gas to or receive gas from TGN. Such transfers occur occasionally during periods of high demand for gas.

*Neuba II.* TGS's newest pipeline, Neuba II, was built in 1988 and is TGS's other pipeline serving the Neuquén basin. Neuba II begins at YPF's Loma de la Lata gas treatment plant in the western portion of the basin and runs through the provinces of Neuquén, Río Negro, La Pampa and Buenos Aires (through the Cerri Complex), up to its terminal station located at Ezeiza just outside of Buenos Aires. Neuba II is a principal source of gas for the Federal District and the greater Buenos Aires area.

*Other Pipelines.* Includes the Cordillerano pipeline, built in 1984, which receives gas from the Neuquén Basin and supplies it mainly to three tourist centers in Southern Argentina. In addition, TGS operates other minor pipelines, the high pressure transmission ring around Buenos Aires, the Chelforó-Conesa pipeline and other pipelines known as gas transfer pipelines.

## **Gas Processing**

TGS's gas processing activities are conducted at its Cerri Complex. It is located near the city of Bahía Blanca and is connected to each of TGS's main pipelines. The Cerri Complex consists of an ethane extraction plant to recover ethane, propane, butane and natural gasoline, together with a lean oil absorption plant to recover propane, butane and gasoline. The facility also includes compression, power generation and storage facilities. The Cerri Complex processing capacity is approximately 43 MMm<sup>3</sup>/d (1,519 MMcf/d).

As part of the Cerri Complex, TGS also maintains at Puerto Galván a storage and loading facility for the natural gas liquids extracted at the Cerri Complex. The Cerri Complex, including the Puerto Galván facility, is currently capable of storing 32,341 short tons, or the equivalent of 14 days of production of propane, butane and natural gasoline. In 1998, TGS completed the expansion of the processing and storage facilities of the Cerri Complex. For a more detailed description of the expansion, see "Description of Business - Gas processing and other services".

## **Ancillary Facilities**

### *Cathodic Protection System*

Currently, TGS operates 213 cathodic protection devices, which are located along its main pipelines. The objective of this system is to mitigate the corrosion process on the pipe's surface. The corrosion process causes metal losses, which depending on the severity of the damage may cause pipeline ruptures. Cathodic protection equipment includes thermic, turbine-driven, motor-driven or even solar electric generators in locations where no electric lines are available. The system also includes an impressed current-deep anode, which facilitates circulation of electricity through in the circuit formed by the generator, the anode itself, the pipe and the land.

### *Telecommunications System*

In 1998, TGS completed the construction of a digital radio telecommunications system. This fifth generation system runs parallel to TGS' main pipelines, from the southernmost province of Tierra del Fuego and Neuquén in the west, to the Company's headquarters in Buenos Aires. The system is controlled from the Company's headquarters and has a capacity of 120 channels of 64 kilobytes per second each one.

In September 1998, TGS and Enron Argentina created TELCOSUR S.A. ("TELCOSUR"), a sole purpose company, which purpose is to provide digital telecommunication services. TGS expects to maximize the use of the telecommunication system non-utilized capacity. TELCOSUR is owned 99.98% by TGS and 0.02% by Enron Argentina. As of the date of issuance of this Annual Report, TELCOSUR has not rendered any service. However, TELCOSUR expects to enter into some agreements with big telecommunication companies and clients, in order to commercialize the non-used capacity.

### *Gas Control System*

Located at TGS' Buenos Aires headquarters, the gas control system controls scheduled gas injections and deliveries and allows TGS to follow gas flows in real time. Data is received from compressor stations by phone and automatically from remote terminal units ("RTU's") installed in the receipt and delivery points equipped with the EFM system. The information is normally collected by the Supervisory Control and Data Acquisition ("SCADA") system (which has an ad-hoc database that is updated every 30 seconds on average) and is then consolidated in other databases. In order to control gas injection and deliveries, TGS has developed a system software called *Solicitud, Programación, Asignación y Control* ("SPAC"), which, among other things, allows TGS to control actual volumes and projected future injections to determine producer deviations. As part of this system, TGS operates meteorological equipment and receives daily weather information from various sources, which is used for the purpose of forecasting the gas demand.

### *Gas Measurement*

Shipped and delivered gas is measured through field primary facilities that are connected with RTU's. Such RTU's transmit the data to the Buenos Aires headquarters. This data is utilized to prepare reports for clients, shippers, producers and ENARGAS. Energetic balances are also prepared in order to control TGS system efficiency.

### **ITEM 3. LEGAL AND REGULATORY PROCEEDINGS**

In April 1996, GdE filed a legal action seeking reimbursement from the Company of US\$ 23 million paid by GdE under purchase orders issued in connection with two compressor plants. The Company has recorded such plants as "Property, plant and equipment" valued at Ps. 4.8 million based on the replacement cost of similar compressor equipment. TGS has thoroughly answered the demand and is contesting the claim.

As of the date of issuance of this Annual Report, GdE directly or through ENARGAS, has not fulfilled the obligations set forth in the Transfer Agreement and in the License in connection with its responsibility for the five-year period ending on December 31, 1997, for the registering of easements relating to the transferred pipeline system which have not been properly registered and for related payments to property owners of any required easements. In order to fulfill its capital expenditures program related to the system integrity and public safety required by the License, the Company has entered into easement agreements with certain land owners and paid related amounts. Consequently, the Company filed a claim against GdE to recover such amounts paid.

On October 7, 1996, the Executive Branch, through Decree N° 1,136/96, created a contribution fund, as provided for in the License, to assume GdE's obligations for paying easements and any other compensation to land owners for an initial five-year period, beginning with the privatization and ending on December 28, 1997. ENARGAS manages the above mentioned fund, which is financed by a special charge included in the transportation rates and reimbursed to ENARGAS. TGS has filed against GdE-ENARGAS an administrative claim asking for the amounts paid in connection with easements related to facilities existing prior to December 28, 1992. At December 31, 1999 the Company has accrued approximately Ps. 4.2 million in the account "Other current receivables" for this concept. In December 1997, ENARGAS declared that it will allow the reimbursement of the useful expenses, as determined by the Government, derived from easements. The Company expects to fully recover the amounts paid, based on its rights derived from the License.

In connection with the easements payable starting January 1, 1998, TGS is negotiating with the ENARGAS the recovery of amounts paid through increases in the transportation rates. As of December 31, 1999, the Company has accrued approximately Ps. 6.4 million for this concept in the account "Other non-current receivables". The Company expects, based on its rights, to fully recover the amounts paid.

In 1997, the Company received a preliminary assessment from the Tax Bureau of the Neuquén Province related to stamp tax derived from transportation contracts entered into between TGS and four gas distribution companies shortly before the take-over date of TGS and while GdE was the sole shareholder of the Company. In December 1999, the Tax Bureau of the Neuquén Province formalized the claim through a final assessment for an amount of approximately Ps. 97 million (with its related interest as of December 31, 1999). Moreover, proceedings integration was set in order to evaluate eventual penalties application. TGS' management believes that these contracts were not subject to provincial stamp taxes because the parties to the contracts at the time they were formed, were governmental entities that were exempt from the tax. Moreover, even if the contracts were subject to provincial stamp taxes, management believes that GdE would bear responsibility for this tax under the Transfer Agreement. As regards the preliminary assessment, the Company has notified GdE of its position and has filed an appeal with the Tax Bureau of the Neuquén Province requesting that the relevant statute of limitations be enforced on the tax obligation claimed by such province. However, if the Company were forced to pay any amount, it would have the right to be reimbursed by GdE or the Argentine Government. The Argentine Government has recognized that is responsible for the payment of such tax. In connection with the final assessment received in December 1999, TGS filed an appeal to the Tax Bureau of the Neuquén Province.

In December 1998, TGS received another preliminary assessment from the Tax Bureau of the Neuquén Province in the amount of approximately Ps. 17 million related to the stamp tax (and related interests as of December 31, 1998) arising from the Transfer Agreement subscribed by TGS in the privatization of GdE. TGS' management believes, as in the assessment described above, that this transfer was not subject to the stamp tax, as expressly defined in the first part of the

above paragraph. However, if the Company were forced to pay any amount, it would have the right to be reimbursed by GdE or the Argentine Government. The Company has notified the Argentine Government of its position and proceeded to request that the relevant statute of limitations be enforced on the tax obligation. Additionally, TGS received another preliminary assessment from such Tax Bureau regarding the Technical Assistance Agreement. TGS has asserted that such tax is unfounded mainly because the agreement has no effects in such province.

In May 1999, TGS was notified of a preliminary assessment by the Tax Bureau of the Río Negro Province related to the stamp tax on transportation service offer letters received from shippers in the claimed amount of approximately Ps. 87 million plus Ps. 86 million of interests and Ps. 168 million as penalties. In September 1999, the Tax Bureau of the Río Negro Province formalized the claim through a final assessment. Additionally, TGS was notified in October 1999 of a preliminary assessment by the Tax Bureau of the Santa Cruz Province in connection with stamp tax to be levied on transportation service offer letters received from shippers, for an amount of approximately Ps. 17 million (not including interests nor penalties). The assessments of both provinces comprise transportation agreements entered into by TGS and several shippers, both before TGS take-over and when GdE was the sole shareholder of the Company, as well as the offer letters received after such date. TGS' management believes, as in the case of the Neuquén Province, that agreements prior to the take-over were not subject to the application of provincial stamp tax, since the subscribing parties belonged to the Argentine Government, which is exempt from the stamp tax. In addition, TGS' management believes that, even if the contracts signed before the take-over were subject to the stamp tax, GdE would be responsible for the payment of such tax, according to the Company Transfer Agreement provisions. If the Company were forced to pay any amount arising from these agreements, it would have the right to be reimbursed by GdE or the Argentine Government.

In connection with the remaining assessments, the Company's management believes that offer letters for transportation service rendering are not subject to the tax mentioned above. Should they be taxable, TGS believes that such event must be considered a change in the interpretation of the tax law, and its impact should be reflected in the tariff according to regulations on the subject. ENARGAS believes that the claims for stamp tax lack of merit because it considers the tax unlawful.

The Company believes that all assessments in connection with agreements and offer letters prior to January 1, 1994 have been extinguished. The Company has notified GdE of its position and will appeal through an administrative motion within legal terms before the Tax Bureau of the Río Negro Province, which will pronounce judgement on the appeal. In regard to the preliminary assessment of the Tax Bureau of the Santa Cruz Province, TGS has notified GdE of its position and will file its appeal to such province entity. Furthermore, TGS filed a declaratory action of certainty before the Supreme Court of Justice ("SCJ"), so that such entity pronounces judgement on the legitimacy of the Santa Cruz Province Tax Bureau claim. In addition, until SCJ pronounces judgement on the issue, TGS requested a preventive measure from such entity.

In addition to the matters discussed above, the Company is a party to certain lawsuits and administrative proceedings arising in the ordinary course of business.

TGS management believes that the final outcome of the lawsuits and proceedings discussed above, based on the arguments described for each case, will not have a material adverse effect on the Company's financial position and results of operations.

Additionally, TGS requested to ENARGAS an adjustment to its gas transportation tariffs, as provided in the License, in order to recover through them the burden of the new tax on interest payments and financial costs established by Law N° 25,063. ENARGAS overruled the request on the grounds that it considers the above mentioned tax as similar to income tax (the only tax which can not be reflected in tariffs). TGS filed a subsidiary motion of review to the Federal Energy Bureau, which has not pronounced a resolution by the date of the issuance of this Annual Report. As of December 31, 1999, "Net financial expense" includes approximately Ps. 7.9 million for such tax.

#### **ITEM 4. CONTROL OF REGISTRANT**

TGS's controlling shareholder is CIESA, which together with Perez Companc and Enron, hold approximately 70% of the Company's common stock. The remaining 30% ownership in the Company is currently held by local and foreign investors.

CIESA is owned 50% by PC and a subsidiary, and 50% by subsidiaries of Enron and has the ability to direct the

management of the Company, to control the election of the majority of the Board of Directors, to determine the dividend policy and other policies of the Company and to determine the outcome of any matter put to a vote of the shareholders of the Company. CIESA may freely dispose of its Class "B" shares in TGS and may transfer or sell any of TGS Class "A" shares under certain conditions and with ENARGAS approval.

The General Director and a number of the Directors and senior managers of TGS were with Enron Argentina or Perez Companac prior to assuming their positions with the Company (see "Directors and Officers of Registrant").

The following table sets forth certain information, with respect to each shareholder known to the Company to own more than ten percent of its Common Shares and the total amount of the Company's Common Shares owned by the directors and executive officers of TGS as a group.

<b>Name of Beneficial Owner</b>	<b>Number of Shares</b>	<b>% Total Common Shares</b>	<b>Class</b>
CIESA	405,192,594	51.000	A
CIESA	34,133,200	3.2962	B
Directors and Executive officers (1)	288,301	0.036	B

(1) As of March 4, 1999.

The Company does not know of any arrangements by virtue of which a change of control may result. Pursuant to the Pliego and the Company's debt agreement, CIESA may not reduce its shareholding in the Company below 51% of the share capital. See "Exchange controls and other limitations affecting security holders".

## **Shareholders Agreements**

**Transfers of CIESA and TGS Shares.** The original holders of the common stock of CIESA entered into two shareholders agreements (the "Shareholders Agreements") for the purpose of governing certain matters relating to their participation in CIESA and in the Company. Perez Companac and Enron Argentina continue to be parties to these agreements. The Shareholders Agreements provide certain rights of first refusal and "tag-along" or co-sale rights in the event of a proposed transfer of CIESA shares. The Shareholders Agreements further provide that any CIESA shareholder must offer to sell to the other shareholders all of its shares of CIESA common stock in the event of a change in control of such shareholder or in certain events of bankruptcy, insolvency or liquidation.

Under the Shareholders Agreements, the sale or transfer of any TGS shares held by CIESA requires the approval of an absolute majority of the directors of CIESA, except that the sale or transfer of TGS shares such that CIESA would own less than 51% of the voting common stock of TGS requires the unanimous vote of the CIESA directors. Such a transaction would also require previous ENARGAS approval.

**Election of TGS Directors and Officers; Voting.** The Shareholders Agreements also contain provisions governing the voting of the TGS shares held by CIESA, the election of Directors and Syndics, the appointment of certain officers of the Company and certain other matters.

The Board of Directors of the Company consists of seven Directors (see "Directors and Officers of Registrant"). Under the Shareholders Agreements, each CIESA shareholder (so long as it retains at least a 15% interest in CIESA) is entitled to direct the appointment of one Director of the Company (the "Core Directors"). If CIESA has the ability to elect additional Directors of the Company, such additional Directors will be designated by the shareholders of CIESA on a rotating basis. The TGS shares held by CIESA are required under the Shareholders Agreements to be voted unanimously for the nominees of the CIESA shareholders.

The following actions by the Company require approval by a majority of the Core Directors: (i) certain sales of assets other than in the ordinary course of business; (ii) adoption of the Company's annual financial plan and certain significant modifications thereto; (iii) certain borrowings, capital expenditures and operating expenses in excess of the amounts approved in the annual financial plan; (iv) appointment of officers other than the General Director (whose appointment is directed by Enron Argentina); (v) certain capital expenditures not approved in the annual financial plan of the Company; (vi) salary and compensation policies; (vii) amendments to the Technical Assistance Agreement; (viii) decisions relating to certain legal claims by or against the Company; (ix) certain decisions relating to tax planning; and (x) granting of certain guarantees, indemnities or similar security arrangements other than in the ordinary course of business and not approved in

the annual financial plan of the Company. Notwithstanding the foregoing, in the case of any decision with respect to an area in which Enron Argentina could have liability under the Technical Assistance Agreement, Enron Argentina's affirmative vote will be required, except in certain circumstances specified in the Shareholders Agreements. Company policies regarding public communication and government relations must be approved unanimously by the Core Directors. Under the Shareholders Agreements a deadlock among the Core Directors with respect to any decision is considered a "no-vote", except that with respect to any area in which Enron Argentina could have liability under the Technical Assistance Agreement, Enron Argentina may adopt one of the proposed alternatives, which will then be binding on the other shareholders.

The Shareholders Agreements further provide that no CIESA shareholder shall compete with the Company in the open access gas transportation business in Argentina or have a preferential position in doing business with the Company.

Under the Shareholders Agreements, PC is entitled to direct the appointment (and removal) of the President of the Board of Directors of the Company, and Enron Argentina is entitled to direct the election (and removal) of the Vice President of the Board of Directors of the Company. Enron Argentina is also entitled to direct the appointment of the General Director, who is the chief executive officer of the Company, and has the authority to direct its day-to-day operations, subject to provisions of the Shareholders Agreements requiring approval by specified proportions of the Core Directors or of all TGS Directors appointed by CIESA. Also, the TGS shares held by CIESA are required under the Shareholders Agreements to be voted unanimously for the nominees of CIESA shareholders on all occasions on which such shares are voted for the election of the first, second and third Syndics (and their alternates), respectively.

**Actions Requiring Special Shareholder Approval.** The Shareholders Agreements provide that all of the TGS shares held by CIESA will be voted in favor of the following Company's actions only if approved by all the directors of CIESA: (i) mergers or sale of all or substantially all of the assets of the Company; (ii) engaging in any business other than the gas transportation business in Argentina; (iii) declarations of dividends in amounts not consistent with the policy set forth in the Shareholders Agreements; and (iv) amendments to the Company's By-laws. Approval by a majority of the directors of CIESA will be required for the favorable vote of the TGS shares held by CIESA with respect to the issuance of additional shares of the Company.

#### **Current shareholders of CIESA**

**Enron Argentina and Enron.** Enron Argentina, incorporated under the laws of the Republic of Argentina, is an indirect wholly-owned subsidiary of Enron. Enron, is one of the world's leading integrated natural gas and electricity company. Enron, which owns approximately US\$ 34 billion as of September 30, 1999 in energy and communication assets, produces electricity and natural gas, develops, constructs and operates energy facilities worldwide, delivers physical commodities and financial and risk management services to customers around the world.

**Perez Companc** is one of the largest private-sector groups in Argentina with approximately US\$ 5.0 billion of total assets as of September 30, 1999. Its related companies are engaged in a wide variety of activities, including oil and gas production, oil field services, petrochemicals and refineries, electric generation, transmission and distribution, gas transmission and forestry.

#### **ITEM 5. NATURE OF TRADING MARKET**

**Trading of the Company's Shares.** Prior to May 5, 1994, there was no public market for the Company's Common Shares or ADSs. On May 5, 1994, the Company established a Rule 144A American Depositary Receipt ("Rule 144A ADR") facility and a Regulation S American Depositary Receipt ("Regulation S ADR") facility, each with Citibank, N.A., as Depositary. On that date, the Argentine Government, as selling shareholder, made an international offering of 195,000,000 Class "B" Shares. A portion of the Class "B" shares was offered in the form of Rule 144A ADRs in the United States pursuant to Rule 144A under the Securities Act and in the form of Regulation S ADRs outside the United States and Argentina, pursuant to Regulation S under the Securities Act.

In November 1994, the Company completed an exchange offer (the "Exchange Offer"), whereby it offered existing Rule 144A ADR holders registered ADRs in exchange for their restricted Rule 144A ADRs. Except for the absence of resale

restrictions, the terms of the registered ADRs received in the Exchange Offer were substantially identical to the terms of the restricted Rule 144A ADRs tendered. The Company has terminated its Rule 144 A ADR facility. Each ADR represents five Class "B" shares.

The table below shows the high and low sales prices of the Class "B" shares on the BASE, stated in Argentine pesos and of the ADRs in the New York Stock Exchange ("NYSE"), stated in US Dollars, for each full quarterly period within the two most recent fiscal years.

Quarters	1999				1998			
	NYSE		Shares in BASE		NYSE		Shares in BASE	
	High	Low	High	Low	High	Low	High	Low
First Quarter	10.44	9.00	2.09	1.80	12.12	10.87	2.36	2.16
Second Quarter	10.13	8.50	2.01	1.78	11.94	10.07	2.36	2.00
Third Quarter	9.94	7.63	1.98	1.54	12.37	7.50	2.46	1.46
Fourth Quarter	9.38	8.00	1.90	1.61	11.00	9.12	2.19	1.82

As of December 31, 1999, approximately 32% of the securities held by the public were held in the form of ADRs. At such date, a total of 15,431,225 ADRs, representing 77,156,125 Class "B" shares, were held by 118 holders of record. Because certain of these ADRs are held by nominees, the number of record holders may not be representative of the number of beneficial owners. In addition, Class "B" shares were held by 3,856 holders as of December 31, 1999.

**The Argentine Securities Market.** In Argentina, the oldest and largest exchange is the BASE, founded in 1854 and on which the majority of equity trades in Argentina are executed. As of December 30, 1999, the market capitalization of shares of the 114 companies (excluding mutual funds) listed on the BASE was approximately US\$ 83.9 billion. At the end of December 1999, the top 10 listed securities represented approximately 82% of the total. Trading in securities listed on an exchange is conducted through the Mercado de Valores ("Stock Market") affiliated with such exchange.

Securities may also be listed and traded through over-the-counter market brokers who must be linked to an electronic reporting system. The activities of such brokers are controlled and regulated by the Mercado Abierto Electrónico S.A. (the "MAE"), an electronic over-the-counter market reporting system that functions independently from the Mercado de Valores de Buenos Aires S.A. (the "Buenos Aires Stock Market") and the BASE. Under an agreement between the BASE and the MAE, trading in equity and equity-related securities is conducted exclusively on the BASE and trading in corporate debt securities is conducted on both the BASE and the MAE. Trading in Argentine Government securities, which are not covered by the agreement, may be conducted on either or both of the BASE and the MAE. The agreement does not extend to other Argentine exchanges.

Changes to the legal framework of security trading have been introduced permitting issuance and trading of new, non-bank financial products in the Argentine capital markets, including commercial paper, new types of corporate bonds and futures and options. The Argentine Government deregulated brokerage fees and eliminated transfer taxes and stamp taxes on securities transactions in November 1991.

**The Buenos Aires Stock Market.** The Buenos Aires Stock Market, which is affiliated with the BASE, is the largest Stock Market in Argentina. The Buenos Aires Stock Market is a corporation whose 250 shares are owned by a number of members who are the only individuals and entities authorized to trade in the securities listed on the BASE. Trading on the BASE is conducted by open outcry and a computer-based negotiation system called SINAC from 11:00 A.M. to 6:00 P.M. each business day. The BASE also operates an electronic continuous market system from 11:00 A.M. to 6:00 P.M. each business day, on which privately-arranged trades are registered and made public. To control price volatility, the Buenos Aires Stock Market operates a system which restricts dealing in shares of any issuer when changes in the price the such issuer's shares vary 15% from the previous closing price, unless trading at the top price.

Investors in the Argentine securities market are primarily individuals, companies and institutional investors consisting of a limited number of mutual funds. The Argentine Congress passed amendments to the social security laws, which took effect July 1, 1994. These amendments partially privatized the government social security system and have substantially increased the assets of Argentine institutional pension funds and the volume of trading on the BASE. Certain information regarding the Argentine equities market is set forth in the table below.

	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>
Market capitalization (US\$ in billions)	54.3	55.6	45.3	83.9

Market capitalization as percent of GDP	20.0%	19.0%	15.2%	29.7%
Average daily trading volume (US\$ in millions)	124.1	151.3	104.8	47.2
Number of listed companies	140	132	129	114

Source: Data published by the Buenos Aires Stock Market and other sources.

## ITEM 6. EXCHANGE CONTROLS AND OTHER LIMITATIONS AFFECTING SECURITY HOLDERS

There are currently no Argentine foreign exchange control restrictions on the payment of dividends on the Class "B" Shares or the conduct of TGS operations. For information regarding historical foreign exchange rates in Argentina and exchange controls in Argentina, see "Exchange Rates".

The Pliego imposed certain restrictions (one of which is also included in TGS's By-laws) on the transfer of the shares of TGS's held by CIESA and on the transfer of Class "A" common shares of CIESA ("CIESA Class "A" Shares") by the shareholders of CIESA.

CIESA may freely dispose of its Class "B" Shares in TGS, but may not transfer or sell any of the TGS Class "A" Shares (representing 51% of the total capital stock of TGS) provided that any action that results in a diminution of CIESA's ownership of TGS capital stock to less than 51%, including a failure by CIESA to subscribe for any increase in TGS capital, may be undertaken only with the prior approval of ENARGAS. ENARGAS approval will be granted only if: (i) the transfer of the TGS Class "A" Shares is made in a single block or results in the new owner holding all of the outstanding TGS Class "A" Shares, (ii) the transfer of the TGS Class "A" Shares does not affect the quality of the gas transportation services provided by the Company and (iii) the technical operator, or a successor thereto that is acceptable to ENARGAS, has at least a 10% interest in the outstanding common stock of the new owner and has entered into a technical assistance agreement with the Company.

The shareholders of CIESA may not transfer or sell any of the CIESA Class "A" Shares (representing 51% of the total capital stock of CIESA) or take any action resulting in a diminution of the ownership of such shareholders in CIESA to less than 51%, including a failure by such shareholders to subscribe for any increase in CIESA's capital, without the prior approval of ENARGAS. In addition, until December 28, 2000 (the expiration date of the required term of the Technical Assistance Agreement), the technical operator may not reduce its ownership in CIESA common stock to less than 10% of the total outstanding without prior ENARGAS approval. This approval will only be granted if, in ENARGAS's sole judgment, the reduction does not adversely affect the business of the Company or the technical operator is succeeded by another operator that is acceptable to ENARGAS. The foregoing restrictions do not apply to transfers between parties belonging to the same "economic group" as defined in the Pliego.

At any time after December 28, 2000, CIESA may request that ENARGAS approves the dissolution of CIESA and the transfer of the TGS shares held by CIESA to the shareholders of CIESA. ENARGAS may grant such approval if it determines that such actions would not adversely affect the public interest.

## ITEM 7. TAXATION

### General

The following is a general summary of certain Argentine and United States federal tax matters that may be relevant to the ownership and disposition of ADSs or Class “B” Shares. The summary describes the principal tax consequences of the ownership and disposition of ADSs or Class “B” Shares, but it does not purport to be a comprehensive description of all of the tax considerations that may be relevant to a holder of ADSs or Class “B” Shares. The summary of United States federal income tax matters applies only to holders of ADSs or Class “B” Shares that hold such ADSs or Class “B” Shares as capital assets and does not apply to special classes of holders such as certain non-resident alien individuals who were previously U.S. Holders, as defined below, dealers in securities, holders whose functional currency is not the U.S. Dollar, tax-exempt organizations, certain insurance companies, financial institutions, traders in securities that elect to mark to market, holders liable for the alternative minimum tax, persons holding the ADSs or Class “B” Shares in a hedging transaction or as part of a straddle or conversion transaction or holders that own, or are treated as owning, 10% or more of the voting shares of the Company.

The summary is based upon tax laws of Argentina and the United States and regulations thereunder as in effect on the date of this Annual Report, which are subject to change. In addition, the summary is based in part on representations of the Depositary and assumes that each obligation provided for in or otherwise contemplated by the Deposit Agreement or any other related document will be performed in accordance with its terms. Holders of ADSs or Class “B” Shares should consult their own tax advisors as to the United States, Argentine or other tax consequences of the acquisition, ownership and disposition of the ADSs or Class “B” Shares in their particular circumstances.

### Argentine Taxes

**Taxation of Dividends.** Dividends of cash, property or capital stock of the Company paid or distributed to holders of Class “B” Shares or ADSs are currently exempt from Argentine withholding or other taxes. However, according to Law N° 25,063, published on December 30, 1998, cash or other type of dividend distribution, exceeding accumulated net income at year end determined as stipulated by tax regulations, will be subject to a 35% withholding tax as a sole and definite payment. The Company’s Management does not anticipate any impact derived from this tax on the dividend distribution which will be submitted for approval at the Annual Shareholders’ meeting to be held on February 22, 2000.

**Taxation of Capital Gains.** Capital gains derived by non-Argentine residents from the sale, exchange or other disposition of ADSs or Class “B” Shares are not subject to income tax.

**Tax on Assets (Legal Entities) and Tax on Personal Property (Individuals).** Pursuant to the Argentine Personal Property Tax Law No. 23,966, as amended (the “Personal Property Tax Law”), and the implementing Decree No. 127/96 (the “Decree”), individuals that are deemed to be the “direct owners” of securities issued by entities domiciled in Argentina, including the Company, are subject to an annual personal property tax (the “Personal Property Tax”). The tax is levied on securities held at December 31 of each year. The applicable rate is 0.5% of the personal properties (subject to the Personal Property Tax) which exceed Ps. 102,300. Pursuant to the Law 25,239, approved by the Congress in late December, a new tax rate of 0.75% will be applied to personal properties (subject to the Personal Property Tax) which exceed Ps. 200,000, effective 1999.

The Argentine tax authority has not issued any resolution or non-binding opinion addressing the applicability of the Personal Property Tax to holders of ADSs. Although the Personal Property Tax applies only to “direct owners” of securities, it is unclear whether the term “direct ownership” should be interpreted in this context as meaning record ownership or beneficial ownership. Accordingly, it is unclear whether a holder of ADRs would be deemed to be the “direct owner” of the underlying Class “B” Shares and may be subject to the Personal Property Tax on that basis. The following discussion assumes that the beneficial owner of the ADSs will be treated as the “direct owner” of the underlying Class “B” Shares.

Although Class “B” Shares and ADSs that are held by individuals or undivided estates domiciled outside Argentina technically would be subject to the Personal Property Tax, in light of the Decree it is clear that the Personal Property Tax may not be collected in respect of Class “B” Shares or ADSs that are held by such individuals or undivided estates. Legal entities domiciled in Argentina are not subject to the Personal Property Tax. Legal entities domiciled outside Argentina

are exempt from Personal Property tax.

**Value Added Tax.** The sale, exchange or other disposition of ADSs or Class "B" Shares is not subject to value added tax.

**Transfer Taxes.** The sale, exchange or other disposition of ADSs or Class "B" Shares is not subject to transfer taxes.

**Purchase or Sale of Foreign Currency.** There is no tax on the purchase or sale of foreign currency.

**Deposit and Withdrawal of Class "B" Shares in Exchange of ADSs.** No Argentine tax is imposed on the deposit or withdrawal of Class "B" Shares in exchange for ADSs.

**Other Taxes.** There are no Argentine inheritance or succession taxes applicable to the ownership, transfer or disposition of ADSs or Class "B" Shares. There are no Argentine stamp, issue, registration or similar taxes or duties payable by holders of ADSs or Class "B" Shares.

**Tax Treaties.** Argentina has entered into tax treaties with several countries. A tax treaty between Argentina and the United States has been signed but has not yet been ratified and therefore is not currently in effect. It is not clear when, if ever, the treaty will be ratified or enter into effect.

## **United States Taxes**

**General.** As used herein, the term "US Holder" means a beneficial owner of ADSs or Class "B" Shares who or that is: (i) an individual who is a citizen or resident of the United States, (ii) a corporation organized in or under the laws of the United States or any State, thereof (iii) an estate the income of which is subject to United States federal income tax without regard to its source, or (iv) a trust if a court within the United States is able to exercise primary supervision over administration of the trust and one or more United States persons have the authority to control all substantial decisions of the trust. The term "non-US Holder" means a beneficial owner of ADSs or Class "B" Shares who or that is not a US person for United States federal income tax purpose.

In general, and taking into account the earlier assumptions, for United States federal income tax purposes, beneficial owners of ADSs (which are evidenced by ADRs) will be treated as the owners of the underlying Class "B" Shares.

**Taxation of Dividends.** To the extent paid out of current or accumulated earnings and profits of the Company as determined for United States federal income tax purposes, distributions made with respect to ADSs or Class "B" Shares (other than certain distributions of capital stock of the Company or rights to subscribe for shares of capital stock of the Company) will be includible in the income of a US Holder as ordinary income on the date such distribution is actually or constructively received by the Depositary, in the case of ADSs, or when received by the holder, in the case of Class "B" Shares. Such dividends will not be eligible for the dividend-received deduction generally allowed to U.S. corporations under the Internal Revenue Code of 1986, as amended. Any distribution that exceeds the Company's current and accumulated earnings and profits will be treated as a non-taxable return of capital to the extent of the US Holder's tax basis in the ADSs or Class "B" Shares and thereafter as capital gain. Dividends paid in Argentine pesos will be includible in the income of a US Holder in a U.S. Dollar amount calculated by reference to the exchange rate in effect on the date such dividends are includible in income, whether or not converted into U.S. Dollars. US Holders should consult their own tax advisors regarding the treatment of any foreign currency gain or loss on any pesos received that are not converted into U.S. Dollars at the exchange rate in effect on such date. Dividends generally will constitute foreign source "passive income" (or, in the case of certain holders, "financial services" income) for United States foreign tax credit limitation purposes.

A non-US Holder generally will not be subject to United States federal income tax or withholding tax on distributions received on ADSs or Class "B" Shares that are treated as dividend income or as a return of capital for United States federal income tax purposes. However, a non-US Holder will be subject to United States federal income tax on dividend income if such income is effectively connected with the conduct by the non-US Holder of a trade or business in the United States (and is attributable to a permanent establishment maintained in the United States by such non-US Holder, if an applicable income tax treaty so requires as a condition for such non-US Holder to be subject to United States taxation on a net income basis in respect of income from Shares or ADSs), in which case the non-US Holder generally will be subject to tax in respect of such dividend income in the same manner as a US Holder. Any such effectively connected dividends received by a corporate non US holder may also, under certain circumstances, be subject to an additional "branch profits

tax" at a 30% rate or such lower rate as may be specified by an applicable income tax treaty. A non-US Holder generally will not be subject to United States federal income tax or withholding tax on distributions received on ADSs or Class "B" Shares that are treated as capital gains for United States federal income tax purposes unless such non-US holder would be subject to United States federal income tax on gain realized on the sale of ADSs or Class "B" Shares as discussed below.

**Taxation of Capital Gains.** Gain or loss realized by a US Holder on (i) the sale or other disposition of ADSs or Class "B" Shares or (ii) the Depositary's sale or other disposition of Class "B" Shares received as dividends on the ADSs will be subject to United States federal income tax as capital gain or loss in an amount equal to the difference between the U.S. Dollar value of the amount realized on the disposition and the US Holder's tax basis (determined in U.S. Dollars) in the ADSs or Class "B" Shares. Any such gain or loss will be treated as U.S. source income for United States foreign tax credit limitation purposes.

A non-US Holder of ADSs or Class "B" Shares will not be subject to United States federal income tax or withholding tax on gain realized on the sale or other disposition of ADSs or Class "B" Shares unless (i) such gain is effectively connected with the conduct by the holder of a trade or business in the United States (and is attributable to a permanent establishment maintained in the United States by such non - US Holder, if an applicable tax treaty so requires as a condition for such non - US Holder to be subject to United States taxation on a net income basis in respect of gain from the sale or other disposition of the Shares or ADSs) or (ii) such holder is an individual who is present in the United States for 183 days or more in the taxable year of the sale and certain conditions are met. Effectively connected gains realized by a corporate non-US Holder may also, under certain circumstances, be subject to an additional "branch profits tax" at a 30% rate or such lower rate as may be specified by an applicable income tax treaty. In certain circumstances, a non-US Holder may be required to certify as to its status as a non-US Holder in order to be exempt from withholding.

Deposits and withdrawals of Class "B" Shares in exchange for ADSs will not result in taxable gain or loss.

## **ITEM 8. SELECTED FINANCIAL DATA**

The following table sets forth, for the years and at the dates indicated, selected financial data for TGS. The selected financial data have been derived from the Company's financial statements. This information should be read in conjunction with, and is qualified in its entirety by reference to, the Company's financial statements and notes thereto set forth in Item 18 of this Annual Report and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere herein.

The Company's financial statements and the selected financial information set forth below include the effects of inflation up through August 31, 1995, utilizing the inflation restatement methodology established in TR N° 6. Effective September 1, 1995, following the rules issued by the CNV, the Company discontinued the restatement methodology while maintaining the effects of inflation accounted for in prior periods. The discontinuance of inflation accounting is in compliance with Argentine GAAP, provided that the annual variation in the GLWPI does not exceed 8% per annum. Inflation for each of the years ended from September 1, 1995 was lower than 8%. Therefore, the criteria adopted by the Company is in compliance with Argentine GAAP. Accordingly, selected financial data for the year ended December 31, 1995 includes the effects of inflation up through August 31, 1995. Selected financial data for the years ended December 31, 1999, 1998 and 1997 is presented on a historical basis, except for non monetary assets and their related expenses, which have been restated from the date those assets were acquired through August 31, 1995.

Argentine GAAP differs in certain respects from US GAAP. Note 12 to the Company's financial statements, included elsewhere herein, provides a description of the main differences between Argentine GAAP and US GAAP as they relate to the Company and a reconciliation of significant differences to US GAAP of shareholders' equity at December 31, 1999 and 1998 and net income for the fiscal years ended December 31, 1999, 1998 and 1997.

	At and for the year ended December 31,				
	1999	1998	1997	1996	1995
	(in thousands of pesos, except for per share and per ADS information)				
<b>Income Statement Data:</b>					
Net revenues <sup>(1)</sup>	430,271	395,061	412,341	402,191	393,525
Gross operating profit	319,444	301,480	308,439	297,635	285,940
Administrative and selling expenses	(18,984)	(18,679)	(17,454)	(18,074)	(20,930)
Operating income	300,460	282,801	290,985	279,561	265,010
Net financial expense	(84,954)	(48,771)	(44,667)	(42,599)	(19,327)
Net income before income tax	212,482	230,333	245,156	236,589	245,507
Net income	145,724	156,482	167,985	163,789	181,036
<b>Per Share Data<sup>(2)</sup></b>					
Earnings per share	0.18	0.20	0.21	0.21	0.23
Earnings per ADS	0.92	0.98	1.06	1.03	1.14
Cash dividends per share declared <sup>(3)</sup>	0.17	0.200	0.200	0.195	0.190
Cash dividends per ADS declared <sup>(3)</sup>	0.83	1.000	1.000	0.975	0.950
<b>Balance Sheet Data:</b>					
Property, plant and equipment, net	1,949,773	1,848,022	1,704,169	1,578,316	1,544,509
Total assets	2,135,335	1,993,481	1,876,752	1,717,101	1,704,467
Total current liabilities	478,169	306,285	379,498	261,646	329,762
Total non-current liabilities	599,702	616,557	424,198	391,485	323,570
Shareholders' equity	1,057,464	1,070,639	1,073,056	1,063,970	1,051,135
<b>Other Data:</b>					
Capital expenditures <sup>(4)</sup>	152,109	181,846	176,387	71,612	99,132
Depreciation and amortization	46,159	38,594	47,811	45,818	41,738
EBITDA <sup>(5)</sup>	343,595	317,698	337,634	325,006	306,572
<b>US GAAP Information:</b>					
Net income	145,356	141,581	163,936	156,766	157,024
Shareholders' equity	951,421	964,964	982,282	977,245	971,433
Earnings per share <sup>(2)</sup>	0.18	0.18	0.21	0.20	0.20
Earnings per ADS <sup>(2)</sup>	0.91	0.89	1.03	0.99	0.99

(1) Represents gross revenues less gross receipts tax. Includes 353,438; 346,260; 362,730; 353,090 and 351,232 of gas transportation net revenues and 76,833; 48,801; 49,611; 49,101 and 42,293 of gas processing and other services net revenues for the years ended December 31, 1999, 1998, 1997, 1996 and 1995, respectively. The actual transportation tariff is calculated on a dollar basis and converted into pesos as of the date of billing, in accordance with the TGS License.

(2) Earnings and cash dividends per common share under Argentine GAAP and US GAAP have been calculated based on the 794,495,283 common shares outstanding at December 31, 1999. Each ADS represents five shares.

(3) In pesos as of the date of the Shareholders' Meeting or Board of Directors' Meeting which declared such dividends.

(4) Represents additions (excluding materials) and transfers of materials.

(5) Earnings before net financial expense, income tax, depreciation and amortization. Interest expense is presented net of capitalized interest.

**Dividends.** A summary of the dividends paid during the five most recent years is set forth below:

	<u>Million of Ps. (1)</u>	<u>Ps. per share (1)</u>	<u>US\$ per ADS</u>
1995	154.9	0.195	0.975
1996	151.0	0.190	0.950
1997	158.9	0.200	1.000
1998	158.9	0.200	1.000
1999	158.9	0.200	1.000

(1) Stated in Ps. as of the payment date.

Dividends paid in 1995 included dividends in respect of second half of 1994 earnings and an anticipated distribution based on first half of 1995 earnings which totaled Ps. 75.5 million, or Ps. 0.095 per share (US\$ 0.475 per ADS). In 1996, the Company paid the remaining cash dividends for 1995 earnings which amounted to Ps. 75.5 million, or Ps. 0.095 per share (US\$ 0.475 per ADS) and made an anticipated distribution based on first half of 1996, amounting to Ps. 75.5 million, or Ps. 0.095 per share (US\$ 0.475 per ADS). In 1997, TGS paid the remaining cash dividends for 1996, based on second half of 1996 earnings, amounting to Ps. 79.5 million or Ps. 0.10 per share (US\$ 0.50 per ADS), and made an anticipated distribution based on the first half of 1997 earnings, amounting to Ps. 79.4 million, or Ps. 0.10 per share (US\$ 0.50 per ADS). In 1998, the Company paid the remaining cash dividends for 1997, based on second half of 1997 earnings, amounting to Ps. 79.5 million, or Ps. 0.10 per share (US\$ 0.50 per ADS), and made an anticipated distribution based principally on the first half of 1998 earnings, amounting to Ps. 79.4 million, or Ps. 0.10 per share (US\$ 0.50 per ADS).

In 1999, the Company paid the remaining cash dividends for 1998, based on second half of 1998 earnings, amounting to Ps. 79.5 million, or Ps. 0.10 per share (US\$ 0.50 per ADS), and made an anticipated distribution based principally on the first half of 1999 earnings, amounting to Ps. 79.4 million, or Ps. 0.10 per share (US\$ 0.50 per ADS). The Board of Directors submitted for approval of the Annual Ordinary Shareholders' Meeting a distribution of dividends amounting to 52.4 million, or Ps. 0.066 per share (US\$ 0.33 per ADS), based principally on 1999 second half earnings. Such distribution is scheduled to February 29, 2000. See taxation of dividends in "Taxation". The payment represents a dividend payout ratio of approximately 70% of TGS's second half 1999 net income. The dividend reduction is consistent with the Company's future growth strategy (for detailed information refer to "Management's Discussion and Analysis of Financial Condition and Results of Operations").

Dividends may be lawfully declared and paid only out of the Company's retained earnings reflected in its annual financial statements and approved by a shareholders' meeting as described below. The Board of Directors of the Company may declare interim dividends, in which case the members of the Board of Directors and of the Statutory Audit Committee are jointly and severally liable for such distribution, if such declaration is not in accordance with the Business Associations Law and the Company's by-laws.

The Board of Directors regularly submits the financial statements of the Company for the preceding fiscal year, together with reports thereon by the Statutory Audit Committee, to the annual ordinary shareholders' meeting for approval. No later than April 30 of each year, an ordinary shareholders' meeting must be held to approve the financial statements and determine the allocation of the Company's net income for such year. Under the Business Associations Law, the shareholders are required to allocate not less than five percent of such net income to a Legal Reserve until the amount of such reserve equals 20% of the Company's subscribed capital plus adjustments to capital. If the Legal Reserve is subsequently impaired, dividends may not be paid until the Legal Reserve has been restored to its former level. The Legal Reserve is not available for distribution. Under the Company's By-laws, after the allocation to the Legal Reserve has been made, an amount will be segregated to pay the fees of the members of the Board of Directors and of the Statutory Audit Committee, an amount will be segregated to pay dividends on preferred stock, if any, and an amount equal to 0.25% of the net earnings for the fiscal year will be segregated to pay the participation in earnings of employee profit-sharing certificates. The remainder of the retained earnings for the year may be distributed as dividends on common stock or retained as a voluntary reserve, as determined by the shareholders' meeting. Dividends must be paid within 30 days of their declaration.

## **ITEM 9. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion of the financial condition and results of operations of the Company should be read in conjunction with the Company's financial statements for the years ended December 31, 1999, 1998 and 1997, which have been prepared in accordance with Argentine GAAP. Such financial statements include the effects of inflation up through August 31, 1995, as described in Note 2.a) to the financial statements included elsewhere herein.

The financial information shown in this section is presented in accordance with Argentine GAAP. Argentine GAAP differs in certain respects from US GAAP. Note 12 to the Company's financial statements, included herein, provides a description of the main differences between Argentine GAAP and US GAAP as they relate to the Company and a reconciliation of significant differences to US GAAP of shareholders' equity at December 31, 1999 and 1998 and net income for the fiscal years ended December 31, 1999, 1998 and 1997.

## 1. RESULTS OF OPERATIONS

The following table presents a summary of the results of operations for the years ended December 31, 1999, 1998 and 1997:

	1999	1998	1997
	(in millions of pesos)		
<b>Net revenues</b> .....	<b>430.3</b>	<b>395.1</b>	<b>412.3</b>
Gas transportation .....	353.5	346.3	362.7
Gas processing and other services .....	76.8	48.8	49.6
<b>Operating costs</b> .....	<b>110.8</b>	<b>93.6</b>	<b>103.9</b>
Labor costs .....	18.3	19.0	22.5
Depreciation .....	42.3	34.5	44.8
Other operating costs .....	50.2	40.1	36.6
<b>Gross operating profit</b> .....	<b>319.5</b>	<b>301.5</b>	<b>308.4</b>
Administrative and selling expenses .....	19.0	18.7	17.4
<b>Operating income</b> .....	<b>300.5</b>	<b>282.8</b>	<b>291.0</b>
Other expenses, net.....	3.0	3.7	1.1
Net financial expense.....	85.0	48.8	44.7
Income tax expense.....	66.8	73.8	77.2
<b>Net income</b> .....	<b>145.7</b>	<b>156.5</b>	<b>168.0</b>

Net income for the year ended December 31, 1999 decreased by 7% when compared to the net income for the previous year, primarily as a consequence of: (i) increased operating costs due to mainly a higher property, plant and equipment depreciation expense, (ii) a material increase in net financial expense, as a result of a higher average indebtedness, increased interest rates and the creation of a new Argentine tax levied on certain financial costs. Both effects were partially offset by a rise in net revenues and a lower income tax expense attributable mainly to the decline in the taxable income.

Net income for the year ended December 31, 1998 was 6.8% lower than for the same period of 1997 primarily due to: (i) lower gas transportation revenues reflecting the application of a one-time reduction of 6.5% to the Company's transportation tariffs effective January 1, 1998, resulting from the application of the efficiency factor, (ii) increased net financial expense as a consequence of a higher average indebtedness, and (iii) higher administrative, selling and other expenses. These effects were partially mitigated by lower operating costs and income tax expense derived from lower taxable income, offset by the increase in the statutory income tax rate from 33% to 35%.

### *Net revenues*

#### **Gas transportation (Regulated business)**

Gas transportation is the Company's primary business and accounted for approximately 82% of the Company's total net revenues earned during the year 1999 and 88% for the years 1998 and 1997. The decrease of the share of 1999 gas transportation revenues in the total revenues is primarily due to a significant increase in the non regulated business revenues. Transportation revenues are derived principally from firm contracts, under which pipeline capacity is reserved and paid for regardless of actual usage by the shipper. During 1999, firm transportation revenues represented 98% of total net revenues derived from the regulated business. TGS also provides interruptible transportation services subject to available pipeline capacity.

Net transportation revenues for the year ended December 31, 1999, were 2% higher than for the same period of 1998, primarily because of higher firm average contracted capacity, which rose from 55.4 MMm<sup>3</sup>/d (1.96 Bcf/d) for 1998 to 56.2 MMm<sup>3</sup>/d (1.98 Bcf/d) for 1999. The increased contracted capacity reflects additional transportation agreements, which started in May and December 1998, and June 1999. The Company's base transportation tariffs remained flat for the year

1999 given that the investment-related factor ("K Factor") increases were offset in equal proportion by a net reduction related to the semiannual adjustments for changes in the US PPI. Changes in the US PPI included reductions of 2.42% and 0.64% effective July 1, 1998 and January 1, 1999, respectively, and an increase of 0.24% effective July 1, 1999. Tariffs increases associated to the K Factor, consisted of 0.24%, 1.36% and 0.54%, effective July 1, 1998, January 1, 1999, and July 1, 1999, respectively, as approved by ENARGAS. In January 2000, ENARGAS, through its resolution N° 1,470, and with the previous consent of the gas transportation and distribution companies, approved the postponement of the PPI adjustment, (which corresponds to the first semester of the year 2000), until July 1, 2000. The PPI adjustment represents an increase to the tariff rates of 3.78%. Such extraordinary and one-time postponement implies a financing and subsequent recovery of the adjustment. Also, as part of such resolution, ENARGAS set up a methodology to bill the revenue impact of the adjustment to be accrued during the first half of 2000.

In 1999, TGS completed an expansion on the Neuba II pipeline, which increased available capacity by 1.4 MMm<sup>3</sup>/d (49.4 MMcf/d). Associated investment amounted to approximately US\$ 32 million. The additional capacity has been fully subscribed under firm long-term transportation agreements partially effective in 1998 and with full effect in 2001. In May 1999, TGS concluded an open season which had started in 1998, receiving 2.4 MMm<sup>3</sup>/d (84.8 MMcf/d) in net requests for additional transportation services (representing an approximately 4% increase on its current contracted transportation capacity). The requests were mainly received from industrial customers. Total required investment amounts to US\$ 81 million and consists of the expansion of the San Martín and Neuba II pipelines. At the end of 1999, approximately 75% of the investment was completed and 1.7 MMm<sup>3</sup>/d of such expansion were effective, and the remainder is expected to be effective by mid 2000. The Company does not intend to request a tariff increase from ENARGAS in connection with this expansion project, which will generate annual additional revenues by Ps. 12 million, at current transportation rates. Also, in 1999, the Company concluded two open seasons which resulted in a 0.7 MMm<sup>3</sup>/d (24.7 MMcf/d) increase on firm contracted capacity and the extension of some transportation routes, requested by distribution companies customers. These agreements, which started partially in 1999 and will be fully effective by the end of year 2000, will require approximately US\$ 13 million investments and, once operational, will generate additional annual revenues of approximately US\$ 6 million, at current transportation rates. TGS does not intend to request a tariff increase from ENARGAS in connection with this expansion project. Additionally, as a result of these agreements, some distribution companies customers waived approximately 30% of the total remaining step-down rights, existing as of the beginning of the year 1999.

Net transportation revenues for 1998 declined by 4.5% basically as a result of rate reductions. The first reduction stems from the application of the Efficiency Factor, as determined by ENARGAS in late 1997 as part of the first general rate review process, which takes place every five years. The Efficiency Factor consisted of a one-time up front 6.5% reduction to the Company's transportation rates effective January 1, 1998. The gross revenue impact of such reduction amounted to approximately Ps. 24 million in 1998. The second reduction results from the semi-annual automatic rate adjustments derived from changes in US PPI: declines of 2.42% effective July 1, 1998 and 0.39% effective July 1, 1997, partially offset by a 0.95% increase effective January 1, 1998. Rates reduction effect was somewhat offset by: (i) a Ps. 2.7 million accrual to reflect the easements costs that the Company has to face starting January 1, 1998, and for which it is currently seeking a rate relief from ENARGAS, and (ii) higher firm contracted capacity. Firm average annual contracted transportation capacity increased from 54.5 MMm<sup>3</sup>/d (1.92 Bcf/d) in 1997 to 55.4 MMm<sup>3</sup>/d (1.96 Bcf/d) in 1998 reflecting the impact of new firm transportation agreements entered into in 1998 and the full year effect of other agreements with partial effect in 1997.

Rates for gas transportation services are regulated by ENARGAS. For a more detailed description of TGS rates, see "Regulatory Framework-Regulation of Transportation Rates and Adjustment of Rates". TGS's initial rates, stated in dollars and converted to pesos at the time of billing, were fixed at the time of the privatization of GdE for a five-year period, which ended on December 31, 1997. TGS rates are adjusted semiannually to reflect changes in the US PPI, subject to authorization from ENARGAS, and every five years based on efficiency and investment factors determined by ENARGAS. The efficiency factor is a reduction to the base tariff resulting from future efficiency programs while the investment factor increases the tariffs to compensate for future investments. Also, subject to ENARGAS approval, tariffs may be adjusted to reflect non-recurring circumstances or tax changes, other than income tax. In 1996 and 1997, the ENARGAS conducted the first general rate review process. In 1996, ENARGAS set the weighed average cost of capital to be used for the determination of the efficiency and investment factors at 11.3% per annum. As a result of the rate review process which ended in December 1997, the Company's transportation rates suffered a one-time decrease of 6.5% effective January 1, 1998, based on the application of the efficiency factor, as described above. In connection with the investment factor, the ENARGAS approved the application of periodic increases through January 2002 to the Company's tariffs resulting in a total weighted average of 2.6% as of that date to compensate the Company for approximately US\$ 70 million in investments. These investments, which TGS intends but is not required to undertake, include the modifications to the

Buenos Aires high-pressure ring, the expansion of the Cordillerano Pipeline in Western Argentina, and enhancements to the General San Martín pipeline system in preparation for future expansions. As part of the 2.6%, ENARGAS approved average rate increases for the application of the investment factor of 0.24%, 1.36% and 0.54%, effective July 1, 1998, January 1, 1999, and July 1, 1999, respectively, as already mentioned.

The Company's transportation operations are affected by ENARGAS's interpretation and application of regulations that apply to the Company. There can be no assurance that future developments in the establishment of applicable regulations to the natural gas industry or in the interpretation of such regulations or of the License will be favorable to the Company or that there will not be decisions affecting, or changes made to the regulatory regime which will adversely affect the financial condition or results of operations of the Company.

### **Gas processing and other services (non-regulated business)**

The gas processing and other services segment is not subject to regulation by ENARGAS.

Net revenues from the gas processing and other services segment represented approximately 18% of the Company's total net revenues during 1999 and 12% for 1998 and 1997. Gas processing activities are conducted at the Cerri Complex, located near Bahía Blanca and connected to each of TGS's main pipelines, where ethane, propane, butane and natural gasoline are recovered. In addition, the Company provides certain upstream services, which generally consist of gas treatment, separation, removal of impurities from the natural gas stream, gas compression, wellhead gas gathering and transportation. Also, the Company renders pipeline inspection, construction and maintenance services.

Net revenues for the year ended December 31, 1999 increased by 57% when compared to the previous year, primarily as a result of: (i) an approximate 26% rise in the volumes processed at the Cerri Complex attributable to the conclusion of the Complex expansion, as described below, and the scheduled plant maintenance in 1998; (ii) the commencement of operations of a gas treating and compression plant located in the Rfo Neuquén gas field, acquired from PC at US\$ 35 million, through which TGS renders services to PC until late 2017, and (iii) pipeline construction services rendered to Profertil.

The expansion of the Cerri Complex was completed in December 1998, which consisted of the expansion of the gas processing and storage capacity. As a result, processing capacity increased by 13 MMm<sup>3</sup>/d (459 MMcf/d), and included the construction of a new liquids extraction module, the upgrading of the existing turbo compressors and the construction of two refrigerated storage tanks with a combined capacity of 45,000 m<sup>3</sup>. Construction cost of the expansion amounted to approximately US\$ 76 million. TGS has been able to secure additional gas volumes to process and has entered into agreements with Petrobrás for the sale of propane, butane and natural gasoline produced with the expanded capacity effective from such expansion start-up through December 2000.

Net revenues from the non-regulated business segment for the year ended December 31, 1998 declined by Ps. 0.8 million as compared to 1997, due mainly to: (i) a decrease in volumes processed at the Cerri Complex, resulting from a planned shutdown of the plant in order to assemble new equipment in connection with the expansion of the Complex, and (ii) a significant decline in international reference price for LPG.

At December 31, 1999, TGS had outstanding agreements with YPF, certain gas distribution companies and producers, for firm processing capacity of 38.9 MMm<sup>3</sup>/d (1.4 Bcf/d). Under the existing terms and conditions of the agreement, YPF had processing rights for up to 16 MMm<sup>3</sup>/d (0.56 Bcf/d) until December 31, 2002 and a right to reduce to a minimum of 8 MMm<sup>3</sup>/d (0.28 Bcf/d) from January 1, 2001.

Compañía MEGA S.A. is building and will operate a gas processing plant with a capacity of approximately 36 MMm<sup>3</sup>/d (1.3 Bcf/d). Operations are expected to start by the end of 2000. The MEGA project, as well as any other project that eventually may be developed upstream of the Cerri Complex, may adversely affect TGS's revenues from the gas processing and other services businesses. See "Competition".

### ***Operating costs and administration and selling expenses***

Operating and administrative expenses for the year ended December 31, 1999, were Ps. 17.5 million higher than for the

same period of 1998 due primarily to increased gas transportation maintenance expenses and higher property, plant and equipment depreciation, reflecting the Río Neuquén plant acquisition and the Cerri Complex expansion, both in late 1998.

In connection with the easements payable starting January 1, 1998, TGS is currently negotiating with the ENARGAS the recovery of the amounts paid, through increases in the gas transportation rates. As of December 31, 1999, the Company has accrued Ps. 6.4 million for this concept in the account "Other non-current receivables". The Company expects, based on its rights, to fully recover the amounts paid.

Operating costs and administrative and selling expenses for the year ended December 31, 1998 declined by Ps. 9 million as compared to 1997 due primarily to lower labor costs achieved through the Company's ongoing efficiency initiatives, and lower depreciation expenses of property, plant and equipment attributable to an extension of the average useful life of the fixed assets related to the gas transportation service. These effects were partially mitigated by one-time expenses associated to construction services rendered during the first quarter of 1998 and by easements costs that the Company has to bear starting January 1, 1998, as described above. The reduction in depreciation expenses resulted from the periodic evaluation of the average useful lives of the assets allocated to both the transportation and gas processing services, as provided by the rate-composite method of depreciation used by the Company. Until December 31, 1997, average useful lives used for the depreciation of the assets allocated to the gas transportation and processing services were 45 and 20 years, respectively. Once the five-year mandatory investment program and other safety and reliability investments performed to meet international standards, amounting in the aggregate to US\$ 240 million, were concluded, the Company performed the revision of the average useful lives during the first quarter of 1998. To such purpose, the Company used the technical services of independent engineering experts who evaluated the condition of the assets allocated to the gas transportation and processing services. Based on the results of such evaluation, a remaining average useful life of 67 years was determined for the assets related to the gas transportation service, effective from 1998. In late September 1999, ENARGAS requested the Company not to consider the useful life reestimation mentioned above, retroactive as of December 31, 1997, until such regulatory authority makes a final decision about the useful lives assigned to the assets related to the gas transportation service. The impact of the reestimation of the average useful life on net income amounted to approximately Ps. 11 million for each of the years ended December 31, 1999 and 1998. On January 24, 2000, the Company was again requested by ENARGAS not to apply the reestimated useful life of the assets allocated to the gas transportation system, notwithstanding the continuance of administrative procedures and subject to the beginning of the duly disciplinary proceedings. The Company believes that this new ENARGAS' request does not modify its position in connection with the reasonability of the reestimation of the useful life. The Company is currently evaluating different ways of action before the proper authorities. If TGS were finally obliged to change the reestimation of the useful life mentioned above, the Company believes it would modify the depreciation charge prospectively and therefore the Company does not expect any significant impact on its financial condition and results of operations for the year ended December 31, 1999.

### *Net financial expense*

Net interest expense for the year ended December 31, 1999, increased Ps. 36.2 million when compared to the previous year as a result of: (i) a 19% increase in the Company's average indebtedness incurred mainly to finance capital expenditures, (ii) a rise in interest rates, reflecting unfavorable international financial market conditions, which together with the amortization of the settlement cost of the hedges of anticipated transactions, as described below, caused the average net cost of debt to increase from 7.5% in 1998 to 9.3% in 1999 and (iii) the creation of a new Argentine tax levied on interest payment and financial costs set by Law N° 25,063. The impact of such new tax on financial expense represented approximately 84 basis points, thus increasing the average all-in net cost of debt for 1999 to 10.1%. TGS requested to ENARGAS an adjustment to its gas transportation tariffs, as provided in the License, in order to recover through them the burden of the new tax on interest payments and financial costs mentioned above. ENARGAS overruled the request on the grounds that it considers such tax as similar to income tax (the only tax which can not be reflected in tariffs). TGS filed a subsidiary motion of review to the Federal Energy Bureau, which has not pronounced a resolution as of the date of issuance of this Annual Report.

Net interest expense for 1998 increased approximately 9% as compared to 1997 principally as a consequence of a 21% increase in the average indebtedness derived principally from increased capital expenditures; partially offset by (i) an increase in interest capitalization reflecting investments with longer construction periods and (ii) a reduction in the average cost of debt, from 8.28% in 1997 to 8.03% in 1998.

Although no assurance can be given, the Company believes that a devaluation of the Argentine peso would not have a

material adverse impact on the Company's operating income because the Company's gas transportation tariffs are dollar-based, while approximately 75% of its costs are peso-denominated. Nevertheless, a significant devaluation of the exchange rate would result in a foreign currency loss, derived from the foreign-currency denominated net debt maintained by the Company which at December 31, 1999 amounted to approximately US\$ 950 million.

### *Income tax expense*

The statutory income tax rate is applicable to taxable income as calculated according to Argentine tax regulations, which differ in certain respects from accounting rules established by Argentine GAAP. For purposes of US GAAP information, further description of deferred tax assets and liabilities is disclosed in Note 12 to the financial statements included elsewhere herein.

Income tax expense declined from Ps. 73.8 million for 1998 to Ps. 66.8 million in 1999, primarily as a consequence of a lower taxable income. Income tax expense for 1998 was Ps. 3.4 million lower than for the same period of 1997, given the decrease in taxable income, partially offset by a Ps. 4.2 million adjustment reflecting an increase in the statutory income tax rate from 33% to 35%, approved in late 1998.

## **2. LIQUIDITY AND CAPITAL RESOURCES**

The primary sources and uses of cash during the years ended December 31, 1999, 1998 and 1997 are shown in the table below:

	<b><u>1999</u></b>	<b><u>1998</u></b>	<b><u>1997</u></b>
	(in millions of pesos)		
Cash flows from operating activities .....	193.8	194.4	187.8
Cash flows used in investing activities .....	(151.3)	(167.1)	(152.8)
Cash flows from financing activities before dividends paid .....	125.4	106.4	153.7
Dividends paid .....	(158.9)	(158.9)	(158.9)
Cash flows used in financing activities .....	(33.5)	(52.5)	(5.2)
Change in cash and cash equivalents .....	<b><u>9.0</u></b>	<b><u>(25.2)</u></b>	<b><u>29.8</u></b>

### *Cash flows from operating activities*

Cash flows from operating activities in the year ended December 31, 1999, remained level with those of 1998, given that the higher interest payment was offset by lower income tax payments (reflecting two additional advanced payments during 1998 as disposed by the Tax Bureau) and increased net revenues.

Cash flows from operating activities in the year ended December 31, 1998, increased by Ps. 6.6 million as compared to 1997 due primarily to lower interest and operating costs payments in 1998. These effects were partially offset by lower revenues, and increased income tax payments resulting from two additional advanced payments as discussed above.

### *Cash flows used in investing activities*

Cash flows used in investing activities amounted to Ps. 151.3 million, Ps. 167.1 million and Ps. 152.8 million in 1999, 1998 and 1997, respectively. The 1999 decrease as compared to 1998 is primarily due to investments during 1998 associated to the Río Neuquén plant acquired from PC and the completion of the Cerri Complex expansion. The 1998 increase as compared to 1997 is attributable to these both effects.

### *Cash flows used in financing activities*

Cash flows from financing activities before dividends paid were Ps. 19 million higher for the year ended December 31, 1999, compared to the same period of 1998, reflecting an increase in borrowed funds to finance principally the Company's 1999 capital expenditures.

Cash flows from financing activities before dividends paid during 1998 decreased approximately Ps. 47.3 million compared to 1997 primarily as a result of increased operating cash flows and the use of the liquidity cash reserve created in late 1997 to fund 1998 cash needs.

Dividends paid amounted to Ps. 0.20 per share (Ps. 1.00 per ADS), during 1999, 1998 and 1997.

Dividends paid in 1999, included an advanced payment of Ps. 79.5 million (Ps. 0.10 per share or Ps. 0.50 per ADS), primarily based on 1999 first half earnings. In connection with 1999 second half earnings, the Company's Board of Directors submitted for approval of the Regular Shareholders' Meeting, to be held on February 22, 2000, a dividend payment of Ps. 0.066 per share (Ps. 0.33 per ADS). The payment represents a dividend payout ratio of approximately 70% of TGS's second half 1999 net income. The dividend reduction, as compared with prior years, is consistent with the Company's future growth strategy, which will be funded by equity, through the partial reduction of the dividend stream, and additional debt.

According to Law N° 25,063, cash or other type of dividend distribution, exceeding accumulated net income at year end determined as stipulated by tax regulations, will be subject to a 35% withholding tax as a sole and definite payment. The Company's Management does not anticipate any impact derived from this tax on the dividend distribution related to the 1999 second half payment.

### *Capital Resources*

The Company relies on cash generated from internal operations as its primary source of liquidity, supplemented by its available credit facilities with commercial banks and access to the capital markets through global programs. In 1999, the Company set up a US\$ 500 million Global Program for the issuance of debt securities, according to CNV regulations, and is registered with the Buenos Aires and Luxembourg Stock Exchanges. In addition, in 1999, the Company raised two loans amounting to US\$ 326 million structured by the Interamerican Development Bank ("IDB"), in which US institutional investors participated. The two transactions have a final maturity of approximately 12 years, with a five-year grace period which results in an approximate average life of eight years. Average interest rate is 9.82%. The structure was rated BBB-, BBB and 2 by Standard & Poor's, Duff & Phelps and the North American Insurance Companies, respectively. Proceeds from the transactions will be used to finance part of the capital expenditures over the period 1998-2002 related to expansions and enhancements of the transportation, gas processing and other services activities (see additional information in Note 5. to the financial statements, included elsewhere herein).

The Company's Board of Directors has submitted for approval of the next regular Shareholders' Meeting, the setting of a US\$ 300 million Global Program for the issuance of short and medium term debt securities. This Global Program will replace the Global Program for the issuance of short-term debt securities of US\$ 150 million established in February 1997 which matures in April 2000.

The Company must comply with certain restrictive covenants contained in its outstanding debt agreements. For a more detailed description of the main covenants, see Note 5 to the financial statements, included elsewhere herein.

At December 31, 1999, the Company's total outstanding debt was Ps. 997.9 million (see additional information about outstanding debt issues in Note 5 to the financial statements, included elsewhere herein) as compared to Ps. 851.5 million as of December 31, 1998, of which 40% and 28% represented short-term debt, respectively. Total debt as a percentage of total capitalization was 49% and 44% as of December 31, 1999 and 1998, respectively. TGS' dollar-denominated debt has been rated BBB- by Standard & Poor's, who has recently re-confirmed such rating.

As of December 31, 1999, the Company has interest rate swap agreements that hedge approximately US\$ 248 million of outstanding debt exposed to the risk of floating rates. The objective of such agreements is to mitigate the risk of upward

movements in the floating rate, thereby exchanging such floating rates for fixed rates. See Note 5 to the financial statements for additional information related to the hedged debt. Consequently, as a result of the swap agreements entered into by the Company and its fixed-rate debt portion, approximately 74% of TGS' debt as of December 31, 1999 has a fixed interest cost. In addition, in 1998 the Company entered into agreements, which locked in the rate on the 10-year US Treasury Bond at a cost between 5.66% and 5.89% with a notional amount of US\$ 200 million to secure the cost of the IDB transaction, above mentioned. In February 1999, the Company settled one of such agreements with a notional amount of US\$ 100 million. The other agreement with a notional amount of US\$ 100 million was partially settled in March while the remainder was settled in April 1999. The settlement cost of these agreements amounted to approximately Ps. 11 million, which was recorded in the account "Intangible assets" and is amortized over the term of the IDB loan agreement. In addition, the Company entered into a hedge transaction, which locked in the rate on the 5-year US Treasury Bond at 5.62%. The hedge transaction was entered in contemplation of a US\$ 200 million debt issuance based on the 5-year US Treasury rate to refinance the first issuance under the 1993 Global Program. Given the instability in the capital markets, in December 1998, the Company made a second issuance under its 1996 Global Program which consisted of US\$ 200 million in floating rate notes with an 18-month maturity with refinancing purposes (see additional information about outstanding debt issues in Note 5 to the financial statements, included elsewhere herein). Consequently, the approximate Ps. 8 million cost of such hedge agreement settled in January 1999, was allocated as a financing cost of the transaction in the account "Intangible assets" and amortized over the refinancing period. For purposes of US GAAP information under the restrictive criteria of "Statement of Financial Accounting Standard" N°80, mark-to-market accounting was applied to the already mentioned hedge agreement (See note 12 to the financial statements, included elsewhere herein).

At December 31, 1999, short-term debt includes borrowings amounting to approximately 1.8 billion yens and 10 million euros (representing approximately US\$ 25 million at the exchange rate in effect at the inception of the agreements due within 243 days). The Company has entered into foreign currency future agreements to provide protection against a devaluation of the US dollar with respect to the yen and euro, fixing the exchange rate to be in effect at the maturity date of each loan.

The Company believes that cash flows from operations supplemented with external debt financing will provide sufficient liquidity to pay dividends, fund its capital expenditures, cover its debt service and provide sufficient working capital.

### 3. FUTURE CAPITAL REQUIREMENTS

Details of the Company's currently projected capital expenditures for the 2000-2002 period in million of dollars are set forth in the following table:

	2000	2001	2002	Total
<b>Gas transportation</b>				
-Reliability and others (1).....	30.4	27.5	28.9	86.8
-Operational efficiencies .....	1.1	10.6	0.7	12.4
-Expansion .....	39.7	—	—	39.7
Total .....	<b>71.2</b>	<b>38.1</b>	<b>29.6</b>	<b>138.9</b>
<b>Gas Processing .....</b>	<b>3.4</b>	<b>2.8</b>	<b>1.7</b>	<b>7.9</b>
<b>Systems, telecommunications and others .....</b>	<b>2.5</b>	<b>2.4</b>	<b>2.0</b>	<b>6.9</b>
<b>TOTAL CAPITAL EXPENDITURES (2) .....</b>	<b>77.1</b>	<b>43.3</b>	<b>33.3</b>	<b>153.7</b>

(1) Includes US\$ 7.3 million for environmental and industrial safety investments.

(2) TGS may decide to reconsider, adjust or postpone certain capital expenditures.

In addition to the projected expenditures summarized in the table above, the Company anticipates significant additional strategic capital expenditures on projects to expand its gas transportation system and to develop new business opportunities in the non-regulated portion of its business. Additional expenditures estimated at US\$ 350 million are possible over the 2000-2002 period, principally for projects addressed to expand the Company's transportation business, specifically to satisfy increases in the local and regional demand and to acquire and/or construct gas treating and compression facilities.

The foregoing statements regarding capital expenditures are forward-looking in nature. The actual amount of such future capital expenditures will depend on a variety of factors, many of which are beyond the Company's control, and could be

significantly less than US\$ 350 million. These factors include future growth in gas demand in the Argentine and regional markets, the Company's ability to identify and successfully execute specific projects, the presence and competitive impact of competing projects, applicable Argentine and foreign regulations, general economic conditions, including the consequences of the international crisis, and the availability of funding under acceptable terms.

#### **4. YEAR 2000 ISSUE**

The Year 2000 problem resulted from the use in computer information technology ("IT") and non-IT hardware and software of two digits rather than four digits to identify the applicable year. The use of two digits was a common practice for decades when computer storage and processing was much more expensive than today. When computer systems must process dates both before and after January 1, 2000, two-digit year "field" might create processing ambiguities that could cause errors and systems failures. For example, computer programs that had date-sensitive features might recognize a date represented by "00" as the year 1900 instead of 2000. These errors or failures might have limited effects, or the effects might be widespread, depending on the computer chip, system or software and its location and function.

TGS anticipated the significance and weight of the Year 2000 problem, and the need for system compatibility among companies to avoid inconveniences in the normal course of its operations and the operations of third parties with whom TGS has material relationships.

TGS established a Year 2000 project team to address the Year 2000 problem and to prepare its IT and non-IT systems to properly handle date information in the year 2000 and beyond. In addition, the Company hired external resources to address the Year 2000 problems as they related to the Company.

The Company's "Year 2000" project included: (i) corporate-wide awareness activities, (ii) estimation of costs associated with the project, (iii) a comprehensive inventory of IT and non-IT (embedded) systems and the identification of associated risks, (iv) inquiries to suppliers and customers about their state of readiness with respect to the Year 2000 problem, (v) implementation of remedial solutions to the Year 2000 problem, (vi) testing, and (vii) the development of contingency and business plans.

The Company's budget to address the Year 2000 project amounted to Ps. 1.8 million, which at December 31, 1999 was almost completely consumed. The Company has not spent any amount beyond that. Moreover, the Company does not anticipate any significant additional amount in the future to address remaining contingencies, if any. However, given that certain systems and processes are interrelated with systems outside the Company's control and that there are still transactions to occur after January 2000, there may still surface Year 2000 problems. The Company will address remaining contingencies through the application of its corporate general contingency plan.

As of the date of issuance of this Annual Report, the Company has not experienced significant system problems at the turn of the millennium. Consequently, there have been no material effects, resulting from the Year 2000 issue, impacting the Company's 1999 financial condition and result of operations.

#### **CAUTIONARY STATEMENT FOR PURPOSES OF "SAFE-HARBOR" PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995**

TGS is including the following cautionary statement in this Annual Report to make applicable and take advantage of the "Safe Harbor" provisions of the Private Securities Litigation Reform Act of 1995 and the Securities Litigation Uniform Standard Act of 1998, for any forward-looking statement made by, or on behalf of, the Company. The factors identified in this cautionary statement are important factors (but not necessarily all important factors) that could cause actual results to differ materially from those expressed in any forward-looking statement made by, or on behalf of, the Company.

Forward-looking statements in this Annual Report include all statements that express the opinion or belief of the Company or its management as to the future results of operations or business developments of, or relating to the Company. Without limiting the foregoing, the words "believes", "anticipates", "plans", "intends", "expects", and similar expressions are intended to identify forward-looking statements. Forward-looking statements include but are not limited to the following:

- 1) Estimates relating to the Company's capital expenditures plan. The capital expenditures plan may not be fully implemented depending on a variety of factors. The plan and these factors are discussed above.
- 2) Estimates relating to revenues and associated volumes derived from the Company's gas transportation and processing and other services projects. The Company's estimates related to revenues and volumes derived from the Company's gas transportation and processing and other services activities are discussed under "Business-Gas Transportation, Gas Processing and Other Services" and under this section.

As required by that law, the Company hereby identifies the following important factors that could cause actual results to differ materially from any results projected, forecasted, estimated or budgeted by the Company in forward looking statements.

- a) Uncertainties as to the growth rate in the gas demand in the Argentine and regional markets as well as the Company's ability to identify and successfully execute specific projects, the presence and competitive impact of competing projects or the availability of alternate fuels.
- b) Risks and uncertainties impacting the Company as a whole related to changes in general economic conditions, the maintenance of the Convertibility law and the ability of the international capital markets to provide funding under acceptable terms; changes in laws and regulations to which the Company is subject, including tax, environmental and employment laws and regulations; the cost and effects of legal and administrative claims and proceedings against the Company.
- c) Risks and uncertainties for the Company's regulated business primarily related to future ENARGAS' resolutions.
- d) Risks and uncertainties associated with the Company's non-regulated business, primarily related to international prices of LPG.
- e) Remaining contingencies and uncertainties related to the effect of the year 2000 problem.

## **ITEM 9A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Company's primary market risk exposure is associated with changes in the interest and foreign currency exchange rates. Interest rate risk exposure derives from variable rate debt obligations, LIBOR and Fed Composite Rate issuances. Foreign currency risk is a consequence of dollar denominated debt.

According to the authorization granted by TGS' Board of Directors, the Company manages market risk exposure through the utilization of derivative financial instruments entered into only for hedging purposes. Such derivatives financial instruments include interest rate swaps which require payments to (or receipts from) counterparties based on the differential between a fixed and variable interest rate and foreign currency futures which involve cash settlements based on the future estimated price of the foreign currency. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources – Capital Resources" and Note 5. to the financial statements included elsewhere herein. Considering the interest rate swaps agreements, approximately 74% of the outstanding principal debt at December 31, 1999, bears fixed interest rate.

### **Interest Rate Risk**

The following table provides information about the Company's interest rate risk sensitive instruments, including short and long-term debt under interest variable rates and interest rate swaps. For debt obligations, the table presents principal cash flows and weighted average interest rate by expected maturity dates. For interest rate swaps, the table presents notional amounts and weighted average interest rates by contractual maturity dates. Notional amounts are used to calculate the contractual cash flows to be exchanged under the interest rate swaps. Weighted average variable rates are based on current rates as of December 31, 1999.

	<b>Expected maturity dates</b>						<b>Total</b>	<b>Fair value</b>
	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>Thereafter</b>		
	<b>(in million of pesos)</b>							
<b><u>On Balance Sheet Financial Instruments:</u></b>								
<b>Short- term debt</b>	365.3	—	—	—	—	—	365.3	353.7
<b>Average variable rate (%)</b>	10.06	—	—	—	—	—	10.06	
<b>Long-term debt</b>	10.9	18.0	117.1	8.3	8.9	30.4	193.6	140.5
<b>Average variable rate (%)</b>	7.33	7.46	7.53	9.26	9.76	9.88	7.94	
<b><u>Derivative Financial Instruments:</u></b>								
<b>Interest rate swaps: (Pay fixed/ receive variable) <sup>(1)</sup></b>	(0.5)	—	—	—	—	—	(0.5)	(0.5)
<b>Average pay rate (%)</b>	5.60						5.60	
<b>Average receive rate (%)</b>	6.05						6.05	

(1) Notional amounts of derivative agreements amounted to approximately US\$ 248 million at December 31, 1999.

### **Risk of Devaluation of the Argentine Peso**

In the event of a significant devaluation of the Argentine peso, the Company will experience a material loss in its income statement stated in Argentine pesos which might affect the future earnings and consequently dividend distributions. However, if translated into US dollars, TGS' revenue stream is dollar denominated and approximately 75% of its costs are in pesos. Consequently, operating income will not suffer a material adverse effect and net financial expense will remain at the same level since almost 100% of the Company's debt is dollar denominated.

## **ITEM 10. DIRECTORS AND OFFICERS OF REGISTRANT**

### **Board of Directors**

**General.** Management of the business of the Company is vested in the Board of Directors. The Company's By-laws provide for a Board of Directors consisting of seven Directors and seven Alternate Directors. In the absence of one or more Directors, Alternate Directors will attend meetings of the Board of Directors. Directors and Alternate Directors are elected at an ordinary meeting of shareholders to serve one- to three-year renewable terms, as decided by the shareholders. See "Control of registrant".

The current Board of Directors of the Company was elected by the Company's shareholders at the Annual Shareholders' Meeting held on February 17, 1999 for a one-year term.

Under the Company's By-laws and Argentine law, the Board of Directors is required to meet at least once every three months. A majority of the members of the Board constitutes a quorum, and resolutions must be adopted by a majority of the Directors present. In the case of a tie, the Chairman or the person replacing him at a particular meeting is entitled to cast the deciding vote.

***Duties and Liabilities of Directors.*** Under Argentine law, Directors have the obligation to perform their duties with the loyalty and the diligence of a prudent business person. Directors are jointly and severally liable to the Company, the shareholders and third parties for the improper performance of their duties, for violating the law, the Company's By-laws or regulations, if any, and for any damage caused by fraud, abuse of authority or gross negligence. Under Argentine law, specific duties may be assigned to a Director by the Company's By-laws or regulations, if any, or by a resolution of a shareholders' meeting. In such cases, a Director's liability will be determined with reference to the performance of such duties, provided that certain recording requirements are met. Under Argentine law, Directors are prohibited from engaging in activities in competition with the Company without express shareholders' authorization. Certain transactions between Directors and the Company are subject to ratification procedures established by Argentine law.

A Director will not be liable if, notwithstanding his presence at the meeting at which a resolution was adopted or his knowledge of such resolution, a written record exists of his opposition thereto and he reports his opposition to the Statutory Audit Committee before any complaint against him is brought before the Board, the Statutory Audit Committee, a shareholders' meeting, the competent governmental agency or the courts. Shareholders' approval of a Director's performance terminates any liability of a Director vis-à-vis the Company, provided that shareholders representing at least 5% of the Company's capital stock do not object and provided further that such liability does not result from a violation of the law or the By-laws or regulations, if any.

Causes of action against Directors may be initiated by the Company upon a majority vote of shareholders. If a cause of action has not been initiated within three months of a shareholders' resolution approving its initiation, any shareholder may start the action on behalf and for the account of the Company.

The following table sets out the current membership of the Board of Directors of the Company, their respective positions on the Board and the year they were appointed to such position. Except for K. George Wasaff, Rick Lynn Waddell and Donald Black all members live in Argentina.

<b>Name</b>	<b>Year of Appointment</b>	<b>Position</b>
Walter F. Schmale	1992	President of the Board of Directors, Director of PC
Eduardo Ojea Quintana	1998	Vice President of the Board of Directors; Chief Executive Officer of TGS
K. George Wasaff	1996	Director, Principal, Southern Cone, Enron International, Inc.
Daniel Norberto Eloff	1997	Director, Oil business Consultant of PC
Rick Lynn Waddell	1999	Director, Regional Operating Officer, Southern Cone, Enron International, Inc.
Pablo A. Ferrero	1999	Director, Gas and Oil Transportation and Marketing Director of PC
Gustavo A. Mas	1999	Director, Planning and Control Manager of PC
Carlos Manuel Alvarez	1997	Alternate Director, Corporate Finance Director of PC
Daniel E. Rennis	1999	Alternate Director, Investor Relations Manager of PC
Javier Gremes Cordero	1998	Alternate Director, Corporate Finance Manager of PC
Stephen Pearlman	1999	Alternate Director, Vice President of Enron International Argentina S.A.
José Luis de la Fuente	1997	Alternate Director, Technical Consultant of TGS
Donald Black	1999	Alternate Director, Vice President, Southern Cone, Enron International Inc.
Luis Sas	1999	Alternate Director, Capital Market and Project Finance Manager of PC

A new Board of Directors will be elected at the next Shareholders' Meeting to be held on February 22, 2000.

**Executive Officers.** The following list of the Company's current executive officers, their respective positions with the Company and the year they were appointed to such position is referred to positions, effective February 7, 2000:

	<b>Year of Appointment</b>	<b>Position</b>
Eduardo Ojea Quintana	1998	Chief Executive Officer
Jorge García	1998	Director of Marketing
Claudio Schuster	1998	Director of Administration and Finance
Raúl Pedernera	1996	Director of Operations
Daniel Perrone	1999	Director of Regulatory Affairs and Tariffs
Cristian Dougall	1998	Legal Affairs Manager
Luis Atucha	1998	Human Resources and Public Affairs Manager
Alejandro Basso	1998	Planning and Project Evaluation Manager
Alberto Artuso	1993	Engineering Manager

The present principal occupations and employment history of each executive officer of TGS are set forth below:

*Mr. Eduardo Ojea Quintana* received a law degree from the University of Museo Social Argentino. He worked with Perez Companc from 1972 to 1992. At the beginning of TGS' operations, he assumed as Director of Legal, Regulatory and Public Affairs of TGS until March, 1998, when he assumed the position of Chief Executive Officer.

*Mr. Jorge García* received an accounting degree from the University of Buenos Aires. Mr. García worked for the following companies within Perez Companc: Central Costanera S.A. during 1992, Petroquímica Argentina S.A. from 1987 to 1991 and Compañía Naviera Perez Companc from 1980 to 1986. He was TGS' Director of Administration and Finance from 1992 to September 1998, and currently is the Director of Marketing.

*Mr. Claudio Schuster* received an accounting degree from the University of Buenos Aires and a Master Degree in Finance and Capital Markets from the ESEADE. He was associated with Diners Club Argentina from 1981 to 1983 and with Citibank, N.A. from 1983 to 1993. Mr. Schuster was TGS' Director of Internal Audit and Consulting from 1993 to 1998. Mr. Schuster has served as Director of Administration and Finance since September 1998.

*Mr. Raúl Pedernera* received an engineering degree from the Litoral National University of Santa Fe. Before 1992, he worked in the petrochemical areas of Perez Companc. Since he joined TGS, he was Operations Manager in TGS' southern district. He has been Director of Operations since May 1996.

*Mr. Daniel Perrone* received a mechanical engineering degree from the Universidad Tecnológica Nacional. He was associated with Cometarsa S.A., Matoil S.A., Servoil S.A., Bidas S.A.P.I.C. y TransCanada International. Since the end of 1999, he has been the Director of Regulatory Affairs and Tariffs.

*Mr. Cristian Dougall* received a law degree from the University of Buenos Aires. From 1973 to 1993, he worked in the law firm of Dougall & Emery. He joined TGS in 1993. He was Legal and Regulatory Affairs Manager from March 1998 to November 1999. He is currently the Legal Affairs Manager.

*Mr. Luis Atucha* received a law degree from the University of Museo Social Argentino and a Master Degree in Institutional Communications from the UCES. He worked in Banco de la Provincia de Buenos Aires from 1976 to 1989 and in Perez Companc from 1989 to 1992. At the beginning of TGS' operations, he assumed the position of Public Affairs Manager. He has been Human Resources and Public Affairs Manager since October 1998.

*Mr. Alejandro Basso* received an accounting degree from the University of Buenos Aires. He was associated with Perez Companc from 1987 to 1992 and with Quitral-Co from 1992 to 1994. From 1994 to 1998, he acted as Planning and Corporate Control Manager. He has been Planning and Project Evaluation Manager since September 1998.

*Mr. Alberto Artuso* received a mechanical engineering degree from the Universidad Tecnológica Nacional. He worked in GdE from 1972 to 1992. He has been Engineering Manager since 1993.

**Indemnification of Officers and Directors.** Under the Shareholders Agreements, CIESA will act to cause the Company to: (i) limit the liability of each officer and director of the Company for all actions or omissions of such officers and directors, excluding actions or omissions involving bad faith or willful misconduct and (ii) enter into agreements obligating CIESA to defend, indemnify and hold harmless each officer and director of the Company from and against all liabilities, losses, and other expenses incurred by each such officer or director in connection with a pending, threatened or completed civil, criminal, administrative or other proceeding, or any investigation that could lead to such a proceeding, by reason of the fact that such officer or director is or was an officer or director of the Company, excluding actions or omissions involving bad faith or willful misconduct.

**Statutory Audit Committee.** The Statutory Audit Committee is the Company's monitoring body as stipulated in article N° 284 of the Business Associations Law. The Company's By-laws provide for a Statutory Audit Committee consisting of three members ("Syndics") and three alternate members ("Alternate Syndics"). In accordance with the By-laws, two Syndics and the respective Alternate Syndics are elected by a majority vote of the holders of Class "A" Shares of the Company. The remaining Syndic and corresponding Alternate Syndic are elected by the majority vote of the remaining holders of the common stock of the Company. Each member of the Statutory Audit Committee is elected at the annual ordinary shareholders' meeting and serves for a one-year renewable term. Members of the Statutory Audit Committee must be lawyers or accountants qualified under Argentine law. Directors, officers or employees of the Company may not be members of the Statutory Audit Committee. The Company's By-laws require the Statutory Audit Committee to hold meetings at least once per month.

The primary responsibilities of the Statutory Audit Committee consists basically of monitoring the Company's management compliance with the Business Associations Law, the By-laws of the Company and the shareholders' resolutions, and without prejudice to the role of external auditors, reporting to the shareholders at the Annual Ordinary Shareholders' Meeting regarding the reasonableness of the financial information of the Company. Furthermore, the members of the Statutory Audit Committee are entitled to: (i) attend Board of Directors and Shareholders' Meetings, (ii) call to Extraordinary Shareholders' Meetings when deemed necessary, and to Ordinary Shareholders' Meetings when the Board of Directors fails to do so, and (iii) investigate written inquires directed by the shareholders. The Statutory Audit Committee does not control the operations of the Company, neither evaluate Management's decisions, which are the exclusive responsibility of the Board of Directors.

The current members of the Statutory Audit Committee, which were appointed at the Annual Shareholders' Meeting held on February 17, 1999, the year they were initially appointed to the Statutory Audit Committee and the year their term expires, are as follows:

<b>Name</b>	<b>Member since</b>	<b>Term Expires</b>	<b>Position</b>
Juan Duggan	1996	2000	Syndic
Héctor D. Casal	1997	2000	Syndic
Ezequiel A. Calciati	1999	2000	Syndic
Horacio Ruiz Moreno	1997	2000	Alternate Syndic
Antonello Tramonti	1998	2000	Alternate Syndic
Enrique C. Grotz	1999	2000	Alternate Syndic

The present principal occupations and employment history of Syndics of TGS are set forth below:

*Juan Duggan* is a partner of Hope, Duggan y Silva. He received his law degree from the University of Buenos Aires.

*Héctor Daniel Casal* has been associated with the Perez Companc since 1991, most recently as Manager of Legal affairs advising the financing, mining and petrochemical areas of such group. He obtained his law degree from the Universidad Católica Argentina.

*Ezequiel A. Calciati* is a partner of Pistrelli, Díaz y Asociados, member firm of Arthur Andersen. He obtained his degree from the University of Buenos Aires as a Certified Public Accountant

## **ITEM 11. COMPENSATION OF DIRECTORS AND OFFICERS**

The aggregate remuneration paid or accrued by TGS during 1999 to all directors and executive officers (17 persons) was approximately Ps. 2.7 million. TGS does not provide pension, retirement or similar benefits for directors and officers.

**ITEM 12. OPTIONS TO PURCHASE SECURITIES FROM REGISTRANT OR SUBSIDIARIES**

None.

**ITEM 13. INTEREST OF MANAGEMENT IN CERTAIN TRANSACTIONS**

None

**PART III**

**ITEM 15. DEFAULTS UPON SENIOR SECURITIES**

None

**ITEM 16. CHANGES IN SECURITIES AND CHANGES IN SECURITY FOR REGISTERED SECURITIES**

None

**PART IV**

**ITEM 17. FINANCIAL STATEMENTS**

The registrant has responded to Item 18 in lieu of responding to this Item.

**ITEM 18. FINANCIAL STATEMENTS**

Reference is made to pages F-1 through F-34.

**ITEM 19. FINANCIAL STATEMENTS AND EXHIBITS**

(a) The following financial statements are filed as part of this Form 20-F:

**Transportadora de Gas del Sur S.A.--**

	<u>Page</u>
Report of independent public accountants	F-1
Statements of Income for the years ended December 31, 1999, 1998 and 1997	F-2
Balance Sheets as of December 31, 1999 and 1998	F-3
Statements of Cash Flows for the years ended December 31, 1999, 1998 and 1997	F-4
Statements of Changes in Shareholders' Equity for the years ended December 31, 1999, 1998 and 1997	F-5
Notes to Financial Statements for the years ended December 31, 1999, 1998 and 1997	F-6

(b) Exhibits: See Exhibit Index

## SIGNATURE

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the Registrant certifies that it meets all of the requirements for filing this Annual Report on Form 20-F and has duly caused this Annual Report to be signed on its behalf by the undersigned, thereunto duly authorized.

TRANSPORTADORA DE GAS DEL SUR S.A.

(Registrant)

By:

/s/ Eduardo Ojea Quintana

Name: Eduardo Ojea Quintana  
Title: Chief Executive Officer or General  
Director

/s/ Claudio Schuster

Name: Claudio Schuster  
Title: Director of Administration and  
Finance

Dated: February 07, 2000.

## REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Directors of  
TRANSPORTADORA DE GAS DEL SUR S.A.:

We have audited the accompanying balance sheets of TRANSPORTADORA DE GAS DEL SUR S.A. (an Argentine Corporation) as of December 31, 1999 and 1998, and the related statements of income, cash flows and changes in shareholders' equity for the years ended December 31, 1999, 1998 and 1997, all expressed in Argentine pesos as described in Note 2.a) to the financial statements. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards in Argentina, which are in substantial agreement with those in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of TRANSPORTADORA DE GAS DEL SUR S.A. as of December 31, 1999 and 1998, and the results of its operations and its cash flows for the years ended December 31, 1999, 1998 and 1997, in conformity with generally accepted accounting principles in Argentina.

Certain accounting practices used by the Company in preparing the accompanying financial statements conform with generally accepted accounting principles in Argentina, but do not conform with generally accepted accounting principles in the United States of America. A description of the significant differences and a reconciliation, as permitted by the Securities and Exchange Commission of the United States of America, of shareholders' equity as of December 31, 1999 and 1998 and net income for the years ended December 31, 1999, 1998 and 1997 to generally accepted accounting principles in the United States of America are set forth in Note 12 to the financial statements.

Buenos Aires,  
January 12, 2000, except with  
respect to Note 14 as to which  
the date is January 31, 2000

PISTRELLI, DIAZ Y ASOCIADOS

EZEQUIEL A. CALCIATI  
Partner

TRANSPORTADORA DE GAS DEL SUR S.A.

STATEMENTS OF INCOME  
FOR THE YEARS ENDED DECEMBER 31, 1999, 1998 AND 1997

(Stated in thousands of Argentine pesos as described in Note 2.a.,  
except for per share and per ADS amounts in Argentine pesos)

	<u>1999</u>	<u>1998</u>	<u>1997</u>
NET REVENUES (Note 3)	430.271	395.061	412.341
OPERATING COSTS (Note 13.e)	<u>-110.827</u>	<u>-93.581</u>	<u>-103.902</u>
Gross operating profit	319.444	301.480	308.439
ADMINISTRATIVE EXPENSES (Note 13.e)	-16.990	-16.934	-15.461
SELLING EXPENSES (Note 13.e)	<u>-1.994</u>	<u>-1.745</u>	<u>-1.993</u>
Operating income	300.460	282.801	290.985
OTHER EXPENSES, NET	-3.024	-3.697	-1.162
NET FINANCIAL EXPENSE (Note 2.i)	<u>-84.954</u>	<u>-48.771</u>	<u>-44.667</u>
Net income before income tax	212.482	230.333	245.156
INCOME TAX EXPENSE (Note 2.j)	<u>-66.758</u>	<u>-73.851</u>	<u>-77.171</u>
Net income	<u><u>145.724</u></u>	<u><u>156.482</u></u>	<u><u>167.985</u></u>
Earnings per share (Note 2.e)	0.18	0.20	0.21
Earnings per ADS (Note 2.e)	0.92	0.98	1.06

Notes 1 to 14 are integral parts of these statements.

BALANCE SHEETS  
AS OF DECEMBER 31, 1999 AND 1998  
(Stated in thousands of Argentine pesos as described in Note 2.a)

	1999	1998
<b>CURRENT ASSETS</b>		
Cash	11.070	1.437
Investments (Note 13.c)	51.054	51.729
Trade receivables (Note 3)	54.056	41.035
Other receivables	10.810	14.823
Inventories	2.047	1.288
Total current assets	129.037	110.312
<b>NON CURRENT ASSETS</b>		
Trade receivables	9.085	-
Other receivables	9.172	8.610
Investments (Note 11)	12	12
Property, plant and equipment (Note 13.a)	1.949.773	1.848.022
Intangible assets (Note 13.b)	38.256	26.525
Total non current assets	2.006.298	1.883.169
Total assets	2.135.335	1.993.481
<b>CURRENT LIABILITIES</b>		
Accounts payable	46.819	48.016
Loans (Note 5)	398.202	234.976
Payroll and social security taxes	1.097	1.073
Taxes payable (Note 2.j)	28.761	18.490
Other liabilities	3.290	3.730
Total current liabilities	478.169	306.285
<b>NON CURRENT LIABILITIES</b>		
Loans (Note 5)	599.702	616.557
Total liabilities	1.077.871	922.842
<b>SHAREHOLDERS' EQUITY</b>		
Total liabilities and shareholders' equity	2.135.335	1.993.481

Notes 1 to 14 are integral parts of these statements.

TRANSPORTADORA DE GAS DEL SUR S. A.

STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED DECEMBER 31, 1999, 1998 AND 1997

(Stated in thousands of Argentine pesos as described in Note 2.a)

	<u>1999</u>	<u>1998</u>	<u>1997 <sup>(3)</sup></u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net income	145.724	156.482	167.985
Reconciliation of net income to cash flows from operating activities:			
Depreciation of property, plant and equipment	44.964	36.801	46.342
Amortization of intangible assets	7.470	1.793	1.469
Consumption of materials	280	879	2.504
Changes in assets and liabilities:			
Trade receivables	-22.106	6.241	-2.035
Other receivables	3.451	-7.084	-7.664
Inventories	-759	376	214
Accounts payable	3.032	11.383	-3.089
Payroll and social security taxes	24	-206	117
Taxes payable	10.271	-15.264	-6.670
Other liabilities	-440	237	-354
Interests payable and others	1.916	2.726	-11.009
Cash flows from operating activities	<u>193.827</u>	<u>194.364</u>	<u>187.810</u>
<b>CASH FLOWS USED IN INVESTING ACTIVITIES</b>			
Investment in controlled company	-	-12	-
Additions to property, plant and equipment	-151.323	-169.386	-157.208
Cash from investment amortization	-	2.300	4.400
Cash flows used in investing activities	<u>-151.323</u>	<u>-167.098</u>	<u>-152.808</u>
<b>CASH FLOWS USED IN FINANCING ACTIVITIES</b>			
Proceeds from loans	408.114	418.419	309.700
Payment of loans	-180.653	-342.193	-156.608
Net (decrease) / increase in short term debt (1)	-82.907	30.185	44.644
Settlement of hedges of anticipated transactions (2)	-19.201	-	-
Dividends paid	-158.899	-158.899	-158.899
Payment of initial debt assumed under the Transfer Contract	-	-	-44.000
Cash flows used in financing activities	<u>-33.546</u>	<u>-52.488</u>	<u>-5.163</u>
<b>NET INCREASE / (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	8.958	-25.222	29.839
Cash and cash equivalents at the beginning of year	<u>53.166</u>	<u>78.388</u>	<u>48.549</u>
Cash and cash equivalents at the end of year	<u><u>62.124</u></u>	<u><u>53.166</u></u>	<u><u>78.388</u></u>

(1) Less than three-month maturity.

(2) See Note 5. "Swap and hedge agreements".

(3) Amounts reflect certain reclassifications for comparative purposes with 1999 and 1998 amounts.

For supplemental information on cash flows, see Note 4.

Notes 1 to 14 are integral parts of these statements.

TRANSPORTADORA DE GAS DEL SUR S.A.

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY  
FOR THE YEARS ENDED DECEMBER 31, 1999, 1998 AND 1997

(Stated in thousands of Argentine pesos, except for per share and per ADS amounts in Argentine pesos)

	Shareholders' Contributions			Retained earnings			Total Shareholders' Equity
	Capital Stock	Adjustment to capital stock	Subtotal	Legal Reserve	Voluntary Reserve for Future Dividends	Unappropriated Retained Earnings	
<b>Balance as of December 31, 1996</b>	794.495	87.802	882.297	26.551	-	155.122	1.063.970
Resolution of the Ordinary Shareholders' Meeting held on February 17, 1997 and of the Director's Meeting held on July 10, 1997:							
Appropriation to Legal Reserve	-	-	-	8.189	-	-8.189	-
Cash dividends (0.20 per share and 1.00 per ADS - Note 2.e)	-	-	-	-	-	-158.899	-158.899
Net income	-	-	-	-	-	167.985	167.985
<b>Balance as of December 31, 1997</b>	794.495	87.802	882.297	34.740	-	156.019	1.073.056
Resolution of the Ordinary Shareholders' Meeting held on February 17, 1998 and of the Director's Meeting held on July 8, 1998:							
Appropriation to Legal Reserve	-	-	-	8.399	-	-8.399	-
Appropriation to Voluntary Reserve for Future Dividends	-	-	-	-	68.170	-68.170	-
Cash dividends (0.20 per share and 1.00 per ADS - Note 2.e)	-	-	-	-	-2.407	-156.492	-158.899
Net income	-	-	-	-	-	156.482	156.482
<b>Balance as of December 31, 1998</b>	794.495	87.802	882.297	43.139	65.763	79.440	1.070.639
Resolution of the Ordinary Shareholders' Meeting held on February 17, 1999 and of the Director's Meeting held on July 12, 1999:							
Appropriation to Legal Reserve	-	-	-	7.824	-	-7.824	-
Cash dividends (0.20 per share and 1.00 per ADS - Note 2.e)	-	-	-	-	-20.478	-138.421	-158.899
Net income	-	-	-	-	-	145.724	145.724
<b>Balance as of December 31, 1999</b>	794.495	87.802	882.297	50.963	45.285	78.919	1.057.464

Notes 1 to 14 are integral parts of these statements.

## **TRANSPORTADORA DE GAS DEL SUR S.A.**

### **NOTES TO FINANCIAL STATEMENTS**

#### **FOR THE YEARS ENDED DECEMBER 31, 1999, 1998 AND 1997**

(Amounts stated in thousands of Argentine pesos as described in Note 2.a.,  
except for per share and per ADS amounts in Argentine pesos or where otherwise indicated)

#### **1. ORGANIZATION AND START-UP OF THE COMPANY**

Transportadora de Gas del Sur S.A. (the "Company" or "TGS") is one of the companies created as a result of the privatization of Gas del Estado S. E. ("GdE"). The Company commenced commercial operations on December 29, 1992 and is engaged in the transportation and processing of natural gas in Argentina. TGS's pipeline system connects major gas fields in southern and western Argentina with distributors of gas in those areas and in the greater Buenos Aires area. The gas transportation license to operate this system for a period of thirty-five years ("the License") was exclusively granted to the Company. TGS is entitled to a one time extension of ten years provided that it has essentially met the obligations imposed by the License and by Ente Nacional Regulador del Gas ("ENARGAS"). The General Cerri Gas Processing Complex (the "Cerri Complex"), where the Company processes natural gas by extracting natural gas liquids, was transferred along with the gas transmission assets. The Company also renders upstream services and pipeline construction, operation and maintenance services.

TGS's controlling shareholder is Compañía de Inversiones de Energía S.A. ("CIESA"), which together with Perez Companc and Enron Corp. ("Enron") hold approximately 70% of the Company's common stock. CIESA is owned 50% by Perez Companc S.A. and a subsidiary and 50% by subsidiaries of Enron. The remaining ownership of TGS's capital stock is held by local and foreign investors.

#### **2. BASIS OF PRESENTATION OF FINANCIAL STATEMENTS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The Company's financial statements have been prepared in accordance with generally accepted accounting principles in Argentina ("Argentine GAAP") and taking into consideration the regulations of the Argentine Securities Commission (Comisión Nacional de Valores - "CNV"). The financial statements also include certain additional disclosures in order to conform more closely to the form and content required by the Securities and Exchange Commission of the United States of America (the "SEC").

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting year. Actual results could differ from those estimates.

##### **a) Presentation of financial statements in Argentine pesos**

The Company's financial statements include the effects of inflation up through August 31, 1995, utilizing the inflation restatement methodology established in Technical Resolution ("TR") N° 6 of the Argentine Federation of Professional Councils in Economic Sciences ("Argentine Federation"). Effective September 1, 1995, the Company discontinued the restatement methodology, maintaining the effects of inflation accounted for in prior periods, as provided by the CNV rules.

The discontinuance of inflation accounting is in compliance with Argentine GAAP, provided that the annual variation in the general level wholesale price index ("GLWPI") does not exceed 8% per annum. Inflation for each of the years ended since September 1, 1995 was lower than 8%. Consequently, the criteria adopted by the Company is in compliance with Argentine GAAP.

b) Financial instruments

The Company utilizes derivative financial instruments to manage market risks reducing its exposure resulting from fluctuations in the interest rate and in the yen and euro exchange rates. Such instruments are disclosed in Note 5 and include: interest rate swap, foreign currency futures and interest rate swap for anticipated transactions. The Company does not use derivative financial instruments for trading purposes.

Gains and losses related to hedge instruments are deferred and included in the measurement of the gains and losses of the hedged position, which are included in the income statement under "Net financial expense". Gains and losses from hedging anticipated transactions are deferred until the gains and losses of the hedged position occur.

Accrued and realized gains and losses derived from such financial instruments, which at December 31, 1999 were not material, are included in the Balance Sheet as "Loans".

c) Argentine legal requirements

Certain disclosures related to formal legal requirements for reporting in Argentina have been omitted for purposes of these financial statements, since they are not required for SEC reporting purposes.

d) Amounts in foreign currencies

Such amounts have been valued at the relevant exchange rates in effect as of the end of each year, including accrued interest, if applicable. The respective detail is disclosed in Note 13.d).

e) Earnings and dividends per share and per ADS

Earnings and dividends per share and per American Depositary Shares ("ADS") have been calculated based on 794,495,283 outstanding shares during each year. One ADS represents five Class "B" shares.

f) Revenue recognition

Firm transportation revenues are recognized based on the contracted capacity reserved regardless of actual usage. For interruptible transportation services and for certain gas processing contracts, revenues are recognized upon the delivery of natural gas or gas liquids to customers, respectively. For other gas processing and other services contracts, revenues are recognized when services are rendered.

g) Inventories

Consist of natural gas in the pipeline system owned by TGS in excess of line pack, which is classified as property, plant and equipment, valued at replacement cost of the transported gas at the end of each year. The carrying value of inventories does not exceed its recoverable value.

h) Property, plant and equipment

- Assets transferred from the privatization of GdE: its value was determined based on the price paid for the 70% of the Company's capital stock which amounted to US\$ 561.2 million. This price was the basis to determine a total capital stock of US\$ 801.7 million, which when added to the Initial Debt assumed under the Transfer Contract of US\$ 395 million resulted in a total value for property, plant and equipment of US\$ 1,196.7 million. Such value, converted at the exchange rate in effect as of the date of the Transfer Contract, has been

restated for the effects of inflation as described in Note 2.a).

- Line pack: represents the natural gas in the transportation system estimated necessary to keep the system at operating capacity, valued at acquisition cost and restated for the effects of inflation as described in Note 2.a).
- Additions: valued at acquisition cost restated for the effects of inflation as described in Note 2.a). In accordance with the Company's depreciation method, additions are assigned the average useful life applicable to the group of assets into which they are incorporated. The Company capitalizes the net cost of debt used to finance works in progress until such assets are ready to be placed in service. The Company has capitalized all the investments stipulated as mandatory in the License during the first five-year period, in order to achieve system integrity and public safety equal to those required by international standards. Such investments included, among others, the costs of survey programs related to internal and external pipeline inspection, cathodic protection and pipeline replacement and recoating. Repairs and maintenance costs are expensed in the year in which they are incurred.
- Depreciation: the Company uses the straight-line method with a composite or group depreciation rate for all assets allocated to transportation service and to the processing of natural gas. Under this method periodic evaluation of the average useful life is required. Until December 31, 1997, average useful lives used for the depreciation of the assets allocated to the gas transportation and processing services were 45 and 20 years, respectively. The Company reevaluated the average useful lives in early 1998 following the conclusion of the five-year mandatory investment program (See Note 6.b) and other safety and reliability investments performed to meet international standards. In doing so, the Company used the technical services of independent engineering experts who evaluated the condition of the assets allocated to the gas transportation and processing services. Based on the results of such evaluation a remaining average useful life of 67 years was determined for the assets related to the gas transportation service, effective from 1998. In late September 1999, ENARGAS requested the Company not to consider the useful life reestimation mentioned above, retroactive as of December 31, 1997, until such regulatory authority makes a final decision about the useful lives assigned to the assets related to the gas transportation service. The impact of the reestimation of the average useful life on net income amounted to approximately Ps. 11 million for each of the years ended December 31, 1999 and 1998. The Company believes that the reestimation of the useful life is reasonable and has presented its position before the regulatory authority, who at the date of issuance of these financial statements has not responded. TGS also reestimated the average useful life of the gas processing assets considering the recent completion of the Cerri Complex expansion. Based on the technical evaluation of the gas processing assets conditions made by independent engineering experts, a remaining average useful life of 17 years was determined for such assets, effective from the beginning of 1999. The impact of the average useful life extension on net income for the year ended December 31, 1999, is not material.

As required by the composite method of depreciation, upon retirement of assets, the original cost is charged against the related accumulated depreciation. The cost of replacement is charged to maintenance expense unless it increases capacity or efficiency or extends the useful life, in which case such cost is capitalized. However, for unusual retirements the gain or loss related to those retirements is charged or credited to income in the year when incurred.

For depreciation of all other property, plant and equipment, the Company uses the straight-line method at the rates disclosed in Note 13.a), recording the loss or gain on retirement of the assets in income of the year when incurred.

The recorded value of property, plant and equipment, taken as a whole, does not exceed its recoverable value.

i) Intangible assets

Intangible assets are valued at historical cost, restated for the effects of inflation as described in Note 2.a), less related accumulated amortization calculated over a deferral period of primarily thirty-five years for organization and pre-operating costs, cancellation costs of commitments assumed under the Transfer Contract and other costs; and a deferral period of five years for the costs of setting up the 1993 Global Program and the first issuance of Medium Term Notes thereunder, while the settlement costs of the hedge agreements are deferred over the related loan terms.

j) Income tax

The Company accrued income tax using the 35% rate (33% for 1997 fiscal year) on the estimated taxable income.

A reconciliation between the amount accrued as income tax expense and the pre-tax income at the statutory tax rate for the 1999, 1998, and 1997 fiscal years is as follows:

	<u>1999</u>	<u>1998</u>	<u>1997</u>
Pre-tax income .....	212,482	230,333	245,156
Statutory tax rate .....	35%	35%	33%
Income tax expense at statutory rate .....	74,369	80,617	80,901
Differences in property, plant and equipment .....	(6,090)	(7,035)	(3,794)
Net effect of inflation accounting .....	894	1,033	1,427
Others (not individually material) .....	(2,415)	(764)	(1,363)
Income tax expense .....	<u>66,758</u>	<u>73,851</u>	<u>77,171</u>

Income tax accrual, net of advanced payments, included in "Taxes payable" amounted to 23,038 and 17,030 as of December 31, 1999 and 1998, respectively.

k) Shareholders' equity accounts

These accounts have been restated for the effects of inflation as described in Note 2.a), except for "Capital Stock" which is valued at original cost. The effect of the adjustment to restate this account as described in Note 2.a) has been disclosed in the account "Adjustment to Capital Stock".

1) Income statement accounts

Expenses related to depreciation and amortization of non-monetary assets have been restated for the effects of inflation as described in Note 2.a).

The breakdown of "Net financial expense", which consist mostly of interest, separated between those generated on assets and on liabilities, and the deferral of the hedges of anticipated transactions costs for the years ended December 31, 1999, 1998 and 1997 is as follows:

	<b>Gain (Loss) generated on</b>					
	<b>Assets</b>			<b>Liabilities</b>		
	<b>1999</b>	<b>1998</b>	<b>1997</b>	<b>1999</b>	<b>1998</b>	<b>1997</b>
Interest and other .....	5,161	4,205	2,972	(1) (90,115)	(1) (52,976)	(1) (47,639)

(1) Net of 9,451, 9,990 and 5,362 capitalized interest on "Property, plant and equipment" for the years ended December 1999, 1998 and 1997, respectively.

**3. BUSINESS SEGMENT INFORMATION**

The Company's principal business is to provide natural gas transportation services through its pipeline system. Also, the Company processes natural gas at the Cerri Complex and renders other non-regulated services.

Operating income consists of net revenues less operating expenses. In the calculation of operating income, the following items have not been included: other expenses, net; net financial expense and income tax expense.

Assets identifiable with each segment are those used by the Company to develop each business. Assets that cannot be identified with a specific segment have been grouped under "Corporate" and include investments, among others.

There are no sales between the business segments.

<b>At December 31, 1999</b>	<b>Gas transportation</b>	<b>Gas processing</b>	<b>Other services</b>	<b>Corporate</b>	<b>Total</b>
Net revenues .....	353,438	62,774	14,059	—	430,271
Operating income (loss).....	277,174	33,833	8,437	(18,984)	300,460
Depreciation of property, plant and equipment .....	28,165	10,929	3,223	2,647	44,964
Additions to property, plant and equipment (includes work in progress).....	127,159	6,316	11,394	2,225	147,094
Identifiable assets .....	1,787,086	195,099	60,828	92,322	2,135,335

<u>At December 31, 1998</u>	<u>Gas</u>	<u>Gas</u>	<u>Other</u>		
	<i>transportation</i>	<i>processing</i>	<i>services</i>	<i>Corporate</i>	<i>Total</i>
Net revenues .....	346,260	44,675	4,126	—	395,061
Operating income (loss) .....	272,673	26,702	2,105	(18,679)	282,801
Depreciation of property, plant and equipment	26,901	6,766	826	2,308	36,801
Additions to property, plant and equipment (includes work in progress) .....	93,277	51,118	36,419	2,667	183,481
Identifiable assets .....	1,676,351	188,847	43,837	84,446	1,993,481
 <u>At December 31, 1997</u> 					
Net revenues .....	362,730	45,715	3,896	—	412,341
Operating income (loss) .....	276,482	29,365	2,592	(17,454)	290,985
Depreciation of property, plant and equipment	38,116	6,539	135	1,552	46,342
Additions to property, plant and equipment (includes work in progress) .....	134,279	39,781	1,094	3,230	178,384
Identifiable assets .....	1,607,487	150,301	6,483	112,481	1,876,752

The Company provides credit in the normal course of its gas transportation business principally to gas distribution companies and to YPF S.A. (“YPF”). Concentration of credit and principal customers gross revenues from gas transportation for the years ended December 31, 1999, 1998 and 1997 are as follows:

<b>Gas Transportation:</b>	<u>Trade receivables</u>		<u>Gross revenues</u>		
	<u>1999</u>	<u>1998</u>	<u>1999</u>	<u>1998</u>	<u>1997</u>
MetroGas S.A. (2).....	19,749	18,658	169,560	171,840 <sup>(1)</sup>	186,800 <sup>(1)</sup>
Camuzzi Gas Pampeana S.A. ....	7,704	7,915	75,015	77,419	82,004
Gas Natural BAN S.A.....	5,693	4,850	49,597	49,032	50,217
Camuzzi Gas del Sur S.A.....	1,454	1,782	17,518	18,699	20,550
YPF.....	2,284	1,182	12,594	11,894	14,375

(1) Amounts in the table above reflect certain reclassifications for comparative purposes with the 1999 and 1998 amounts.

(2) Perez Companc S.A. sold its indirect shareholding in this company during the third quarter of 1998.

The principal customer in the gas processing and other services segment is YPF, generating gross revenues amounting to 22,864, 21,798 and 21,738 for the years ended December 31, 1999, 1998 and 1997, respectively. Related trade receivable balances amounted to 3,837 and 1,633 as of December 31, 1999 and 1998, respectively.

#### **4. ADDITIONAL INFORMATION ON THE STATEMENTS OF CASH FLOWS**

In the preparation of the statements of cash flows, cash and cash equivalents include investments with original

maturities of three months or less. The Company uses the indirect method which requires a series of adjustments to the year's net income to obtain the cash flows generated by operations.

Cash paid for income tax and interest during the years ended December 31, 1999, 1998 and 1997 is as follows:

	<u>1999</u>	<u>1998</u>	<u>1997</u>
Income tax .....	60,224	89,426	81,251
Interest (net of amounts capitalized) .....	80,532	51,928	61,989

Non-cash investing and financing activities for the years ended December 31, 1999, 1998 and 1997 include fixed assets acquisitions amounting to 21,546, 25,775 and 13,491 unpaid at such dates, respectively, as well as the financed acquisition of fixed assets, which amounted to 335 and 8,744 at December 31, 1998 and 1997, respectively.

As of December 31, 1999, non current trade receivables derived from financed other services revenues amounted to 9,085.

Accounts receivable derived from sales of property, plant and equipment amounted to 2,205 and 2,223 at December 31, 1998 and 1997, respectively, and are classified under "Other current receivables".

## 5. LOANS

At December 31, 1999, TGS is a party to various short-term credit agreements with a total outstanding amount of 398,202 with an interest rate ranging from 6.00% to 10.46%. These loans mainly include 200,476 from the second issuance of notes under the 1996 Global Program; 148,066 from the issuance of notes under the 1997 Global Program and 25,000 from loans in yen and euro currencies, as described below.

Long-term debt outstanding at December 31, 1999 and 1998 consisted of the following:

	<u>1999</u>	<u>1998</u>
-1993 Global Program: third issuance due 2002, interest rate of 6.87% <sup>(1)</sup> .....	99,577	99,436
-1996 Global Program: first issuance due 2001, interest rate of 10.25% <sup>(2) (3)</sup> .....	151,073	151,932
-1996 Global Program: second issuance due 2000 <sup>(1)</sup> .....	—	198,359
-1997 Global Program: due 2000 <sup>(2)</sup> .....	—	149,113
-Inter-American Development Bank ("IDB") Loans due through 2011 (between 9.61% and 10.19%) <sup>(1)</sup> .....	321,597	—
-Other bank borrowings due through 2006 (interest rates ranging between 6.00% and 8.02% in 1999) <sup>(1)</sup> .....	27,455	17,717
	<u>599,702</u>	<u>616,557</u>

(1) Net of unamortized portion of up front fees.

(2) Net of issuance discounts.

(3) Includes unamortized portion of a Treasury lock settlement, which effectively locked in the rate on the five-year US Treasury Bond in opportunity of a debt issuance. The settlement generated an approximately US\$ 6 million gain which was originally deferred and is being amortized over the five-year term of the debt issuance.

Detailed information on significant debt as of December 31, 1999, is as follows:

### - Debt issuances under Global Programs :

#### *1993 Global Program*

At the Shareholders' Meeting held on August 27, 1993, the establishment of a Global Program for the issuance of short and medium Term Notes (Eurocommercial Papers ("ECP") and Euro Medium Term Notes ("EMTN"), respectively) was approved. The Program allowed an aggregate notional outstanding amount at any given time of

US\$ 350 million. At the Shareholders' Meeting held on March 6, 1996, the maximum amount of this Program was increased to US\$ 500 million. The Global Program had been registered with the Bolsa de Comercio de Buenos Aires ("BCBA") and the CNV.

The description of the outstanding issuance under this Global Program is as follows:

- *Third Issuance:* Five-year registered notes due December 18, 2002 in one payment for an aggregate amount of US\$ 100 million bearing interest at six-month LIBOR plus 0.65% through the first year, stepping up to 0.85% in the fifth year. The notes were approved for trading in the Luxembourg Stock Exchange and in the BCBA. Net proceeds from the placement were used to debt refinancing, to finance capital expenditures and working capital needs.

The Shareholders' Meeting held on February 17, 1999, ratified the authorization given by the Shareholders' Meeting held on February 17, 1998 for the creation of a new US\$ 500 million Global Program, to replace this Global Program which matured in late 1998. This Program has been authorized by the CNV, the BCBA and the Luxembourg Stock Exchange.

### ***1996 Global Program***

At the Shareholders' Meeting held on March 6, 1996, the setting up of a new Global Program for the issuance of short-term and medium-term notes up to a maximum outstanding amount at any given time of US\$ 350 million was approved. This Global Program has been registered with the SEC for being able to make issuances of traded debt securities in the US capital markets. The CNV and the BCBA authorized the Program. The description of the outstanding issuances under this Global Program is as follows:

- *First Issuance:* Medium-term (5 years) registered notes in an aggregate principal amount of US\$ 150 million, maturing in a single payment on April 25, 2001, issued at a price of 99.935%. The notes bear interest at an annual fixed rate of 10.25%, payable semi-annually. The funds obtained from this issuance were used as follows: (a) approximately US\$ 100 million to pay or prepay short-term debt, and (b) the remaining for working capital needs. The BCBA has authorized the public trading of this issuance. This issuance is registered with the SEC.
- *Second Issuance:* 18-month registered notes in an aggregate principal amount of US\$ 200 million, maturing in a single payment on June 22, 2000, callable in the case of a future higher term registered notes issuance. The issuance has two tranches. Tranche A, amounting to US\$ 113.3 million, bears interest at LIBOR plus 3.75% through the first semester, stepping up to 4% in the last semester. Tranche B, amounting to US\$ 86.7 million, bears interest at a rate equivalent to 1.48 times the average rate published by the Banco Central de la República Argentina for Dollar denominated certificates of deposit for a 30 days tenor. Net proceeds from the placement were used to refinance the first issuance under the 1993 Global Program mentioned above. CNV has approved the public trading of this issuance.

### **1997 Global Program**

On February 19, 1997, upon delegation of the Shareholders' Meeting held on February 17, 1997, the Board of Directors set the maximum amount of a Global Program for the issuance of notes at US\$ 150 million and the maximum term at 36 months. Notes under this Program bear no interest and are issued at discount rate equivalent to the Fed Composite Rate in effect as of each issuance. Such notes are guaranteed by an irrevocable letter of credit issued by Dresdner Bank AG, New York Branch. The CNV and the BCBA have authorized this Program. Outstanding issuances under this Global Program are as follows:

- *Series BN, BÑ, BO, BP and BQ:* Registered short-term notes amounting to US\$ 20 million each, issued at an average price of 97.28%, due in a single payment from March 27 through 31, 2000, respectively.
- *Series BR, BS, BT, BU and BV:* Registered short-term notes amounting to US\$ 10 million each, issued at an average price of 98.22%, due in a single payment from March 27 through 31, 2000, respectively.

Funds obtained from the above mentioned series were solely applied to refinance prior series issued under this Global Program.

The Company's Board of Directors will submit for approval of the next regular Shareholders' Meeting, the setting of a Global Program up to a maximum amount of US\$ 300 million for the issuance of debt securities, to replace this Global Program which matures in April 2000.

- Other bank borrowings:

Include credit lines granted by the Export Import Bank of USA ("Eximbank") payable over five years in semi-annual installments accruing interest at 180-day LIBOR plus 0.20% or 0.40% per annum depending of the credit line. As of December 31, 1999 and 1998, the current outstanding principal of such debt amounted to 7,974 and 10,019, respectively, and the non-current portion amounted to 21,943 and 10,627, respectively.

At December 31, 1999, the current portion includes borrowings with maturities within 243 days, amounting to approximately 1.8 billion of yens and 10 million of euros (representing approximately US\$ 25 million at the exchange rate in effect at the inception of the agreements). The Company has entered into foreign currency future agreements to provide a protection against a devaluation of the US dollar with respect to the yen and the euro, fixing the exchange rates to be in effect at the maturity date of each loan.

- **IDB loan**

In the first half of 1999, TGS collected funds from the IDB loan agreement which total US\$ 226 million. The transaction has a final maturity of 12 years, with a five-year grace period which results in an eight and a half-year average life. The IDB loan agreement is structured through an A loan disbursement of US\$ 50 million which is funded by the IDB and a B loan disbursement of US\$ 176 million which was raised through a private placement to foreign investors. IDB is the lender of record and administrator for both the A and B loans disbursements. The transaction was priced at 450 basis points over an average US Treasury bond interest rate settled at 5.15% (for US\$ 200 million) and at 375 basis points over LIBOR (for the remaining US\$ 26 million). The proceeds of the transaction are obtained to finance part of the capital expenditures over the period 1998-2002 associated to expansions and enhancements of the transportation, gas processing and other services activities.

Additionally, on November 1999, TGS has received another loan which totals US\$ 100 million from the IDB loan agreement mentioned above. The transaction has a final maturity of eleven and a half years, with a four and a half-year grace period and an eight- year average life. The IDB loan agreement is structured through an A loan disbursement of US\$ 25 million which is funded directly by the IDB and a B loan disbursement of US\$ 75 million which was raised through a private placement to foreign investors. The transaction was priced at 420 basis points over an average US treasury bond interest rate settled at 5.99%. The proceeds of the transaction are obtained to finance part of the capital expenditures over the period 1999-2002 associated to expansions and enhancements of the transportation, gas processing and other services activities.

- Covenants:

The Company must comply with the restrictive covenants contained in its debt agreements which include, among others, the following:

- i) restrictions to create liens: as long as any note issued remains outstanding, the Company may not encumber its assets or its present or future revenues with debt incurred which in the aggregate exceeds US\$ 10 million, unless the Company finances, in full or in part, the purchase or construction of the assets so encumbered.
- ii) restrictions on the level of indebtedness: as of the closing date of annual and/or interim financial statements, debt assumed by the Company may not exceed 60% of the sum of total debt plus shareholders' equity. Additionally, under the IDB loan agreement, debt assumed by the Company may not exceed 65% of the sum of total debt plus shareholders' equity, minus intangible assets, issuance discounts, deferred issuance expenses and other similar to them.
- iii) restrictions on the EBITDA (defined as earnings before net financial expense, income tax, depreciation and

amortization) to “Net financial expense” ratio: this ratio must not be less than 2.5 in any moment.

-Swap and hedge agreements:

As of December 31, 1999, the Company has outstanding interest rate swap agreements with major financial institutions which effectively convert approximately US\$ 248 million of floating-rate debt (LIBO and Fed Composite Rate) to fixed-rate debt (ranging from 5.54% to 5.70%). Such notional amount includes approximately US\$ 148 million hedging the series issued under the 1997 Global Program and US\$ 100 million covering the third issuance under the 1993 Global Program. Through the interest rate swap agreement covering the US\$ 100 million notes mentioned above, the Company set the six-month LIBO rate at an average cost of 5.54%, however if during any semi-annual period, actual LIBO rate exceeds 6.75%, the Company will pay 6.75% for such period. This swap agreement due on June 2000.

In 1998, the Company entered into two agreements which locked in the rate on the US Treasury Bond at a cost between 5.66% and 5.89%, with a notional amount of US\$ 200 million to hedge the interest rate associated to the IDB loan mentioned above. In February 1999, the Company settled one of such agreements with a notional amount of US\$ 100 million. The other agreement with a notional amount of US\$ 100 million was partially settled in March while the remainder was settled in April 1999. The settlement cost of these agreements amounted to approximately Ps. 11 million, which was recorded in the account “Intangible assets” and amortized over the term of the IDB loan agreement.

In addition, the Company entered into a hedge transaction which locked in the rate on the 5-year US Treasury Bond at 5.62%. The hedge transaction was entered in contemplation of a US\$ 200 million debt issuance based on the 5-year US Treasury rate to refinance the first issuance under the 1993 Global Program, above mentioned. Given the instability in the capital markets and the intention to refinance the above mentioned issuance, the Company made the second issuance under the 1996 Global Program amounting to US\$ 200 million and with an 18-month maturity, as described above. Consequently, the approximate Ps. 8 million cost of such hedge agreement settled in January 1999, was allocated as a financing cost of the transaction in the account “Intangible assets” and amortized over the refinancing period.

## **6. REGULATORY FRAMEWORK**

a) General:

The Company's natural gas transportation business is regulated by Law No. 24,076 (“the Natural Gas Act”), and by regulations issued by ENARGAS, who is entitled, among other things, to set the basis for the calculation of, monitor and approve tariffs. Current transportation tariffs are calculated in US dollars and converted into Argentine pesos as of the billing date. The basic gas transportation tariffs charged by TGS were established upon the privatization and may be adjusted, prior authorization, in the following cases: (i) semi-annually to reflect changes in the US producer price index -industrial commodities- (“PPI”) and (ii) every five years according to efficiency and investment factors determined by ENARGAS. The efficiency factor is a reduction to the base tariff resulting from future efficiency programs while the investment factor increases the tariffs to compensate for future investments. Also, subject to ENARGAS approval, tariffs may be adjusted to reflect non recurring circumstances or tax changes, other than income tax.

In 1996 and 1997 the ENARGAS conducted the first rate review process. In 1996, the ENARGAS set the weighted average cost of capital to be used for the determination of the efficiency and investment factors at 11.3% per annum. As a result of the rate review process which ended in December 1997, the Company's transportation rates suffered a one-time decrease of 6.5% effective January 1, 1998, based on the application of the efficiency factor determined by ENARGAS for the second five-year period, 1998-2002. In connection with the investment factor, the ENARGAS approved the application of periodic increases through January 2002 to the Company's tariffs resulting in a total weighted average of 2.6% as of that date to compensate the Company for approximately US\$ 70 million in investments which TGS intends but is not required to undertake, principally include the modifications to the Buenos Aires high-pressure ring, the expansion of the Cordillerano Pipeline in Western Argentina, and enhancements to the General San Martín pipeline in preparation for future expansions.

Transportation rates decreased 0.64%, effective January 1, 1999 derived from PPI adjustments. Effective July 1,

1999, rates increased 0.24%. In January 2000, ENARGAS, through its resolution N° 1,470, and with the previous consent of the gas transportation and distribution companies, approved the postponement of the PPI adjustment, (which corresponds to the first semester of the year 2000) until July 1, 2000. The PPI adjustment represents an increase to the tariff rates of 3.78%. Such extraordinary and one-time postponement implies a financing and subsequent recovery of the adjustment. Also, as part of such resolution, ENARGAS set up a methodology to bill the revenue impact of the adjustment to be accrued during the first half of 2000.

The gas processing and other services segment is not regulated by ENARGAS, and as provided in the Transfer Contract, is organized as a division within the Company and maintains separate accounting information.

The License stipulates, among other restrictions, that the Company may not assume debts of CIESA, or grant credit, encumber its assets or grant any other benefit to CIESA's creditors.

**b) Mandatory Investment Program:**

The mandatory five-year investment plan for the period 1993-1997, which has been approved by ENARGAS, required the Company to invest a total of US\$ 153 million on its natural gas pipeline system, representing US\$ 30.6 million per year beginning in 1993. This mandatory investment plan was related to the operational capability and public safety of the pipeline system and included, among others, cathodic protection, internal inspection and pipeline replacement and recoating.

**c) Essential assets:**

A substantial portion of the assets transferred by GdE has been defined as essential for the performance of the gas transportation service. Therefore, the Company is required to segregate and maintain these assets, together with any future improvements, in accordance with certain standards defined in the License.

The Company may not, for any reason, dispose of, encumber, lease, sublease or loan essential assets nor use such assets for purposes other than providing the licensed service without ENARGAS prior authorization. Any expansion and improvement that the Company may make to the gas pipeline system after the takeover may only be encumbered to secure loans that have a term of more than one year to finance new expansions and improvements to the licensed service.

Upon expiration of the License, the Company will be required to transfer to the Argentine Federal Government or its designee, the essential assets listed in the updated inventory as of the expiration date, free of any debt, encumbrance or attachment, receiving compensation equal to the lower of the following two amounts:

- i) The net book value of the essential assets determined on the basis of the price paid by the acquiring joint venture, and the original cost of subsequent investments carried in US dollars and adjusted by the PPI, net of accumulated depreciation according to the calculation rules to be determined by ENARGAS.
- ii) The net proceeds of a new competitive bidding.

## **7. CAPITAL STOCK AND DIVIDENDS**

**a) General:**

The Company was incorporated on November 24, 1992 with a capital of 12. The first General Ordinary and Extraordinary Shareholders' Meeting held on December 28, 1992, approved an irrevocable contribution against future share subscriptions which, in Argentine pesos as of that date, amounted to 794,483. The shareholders also decided to increase capital stock through the partial capitalization of this contribution which, in Argentine pesos of that date, amounted to 557,297 since an inventory of the assets transferred had not yet been completed. Once the inventory of the assets transferred was completed, the General Ordinary Shareholders' Meeting held on March 24, 1994, approved the capitalization of the balance of the irrevocable contribution against future share subscriptions. Thus, the capital stock was increased by 237,186 to a total of 794,495 in Argentine pesos of that date.

As of December 31, 1999 the Company's common stock subscribed, paid in and issued is composed of:

## Classes of stock

Common stock, nominal value 1, one vote per share:

Class "A" shares.....	405,192,594
Class "B" shares .....	389,302,689
	<hr/>
	794,495,283
	<hr/> <hr/>

The Argentine Government initially held a 27% shareholding in the Company represented solely by Class "B" shares. Such Class "B" shares were sold in two parts: (i) a substantial part in 1994 through a local and international public offering (outside Argentina, the shares were offered under the form of ADSs representing five shares each; the ADSs issued in the United States of America are SEC registered and traded on the New York Stock Exchange) and (ii) the remainder, representing approximately a 2% shareholding in the Company, to local and foreign investors during 1996.

The Company is obligated to maintain the authorization to offer the Company's capital stock to the public and the corresponding authorization for the shares to be listed on the Argentine Republic's authorized securities markets for a minimum period of 15 years from the respective dates on which such authorizations were granted.

### b) Limitation of the transfer of the Company's shares:

The Company's by-laws provide that prior approval of ENARGAS and the unanimous approval of CIESA's shareholders, under agreements among them, must be obtained in order to transfer Class "A" shares (representing 51% of capital stock). The Bid Package states that approval of ENARGAS will be granted, provided that:

- The sale covers 51% of capital stock or, if the proposed transaction is not a sale, the act of reducing the shareholding will result in the acquisition of a shareholding of not less than 51% by another investment company;
- The applicant provides evidence to the effect that the transaction will not impair the operating quality of the licensed service;
- The existing technical operator, or a new technical operator approved by ENARGAS, holds the minimum required 10% of the new investor company's shares and a technical assistance contract remains in force.

In the case of shareholders of CIESA who have qualified due to the equity, guarantee and/or technical background of their respective parent companies, the sale of shares representing the capital of such subsidiaries by the respective ultimate, direct or indirect parent companies, and/or the cessation of the management running the Company, requires the prior authorization of ENARGAS.

In case the Company wishes to reduce its capital, redeem its shares or distribute any part of its equity, except for the dividends payment, in accordance with the provisions of the Argentine Business Associations Law, it should require prior authorization from ENARGAS.

### c) Dividend distribution:

The Board of Directors will submit for approval at the Annual Ordinary Shareholders' Meeting to be held in February 22, 2000, a distribution proposal of 1999 earnings and the voluntary reserve for future dividends determined by the Shareholders' Meeting held on February 17, 1999. The distribution base is 203,653 and the distribution proposal is as follows: (i) cash dividends amounting to 131,886 or 0.166 per share (0.83 per ADS) for the fiscal year ended December 31, 1999, of which 79,449 or 0.10 per share (0.50 per ADS) were paid in advance in July 1999, based mainly on 1999 first half earnings, (ii) legal reserve amounting to 7,286 and (iii) to keep in retained earnings amounting to 64,481.

According to Law N° 25,063, cash or other type of dividend distribution, exceeding net income determined as stipulated by tax regulations, will be subject to a 35% withholding tax as a sole and definite payment. The Company's Management does not anticipate any impact derived from this tax on the dividend distribution above

mentioned.

d) Restrictions on retained earnings:

Under current Argentine legal requirements, 5% of net income per year must be appropriated into a legal reserve until such reserve equals 20% of total capital stock adjusted for inflation.

In addition, the by-laws provide for the issuance of Profit Sharing Vouchers, as defined in Article 230 of the Argentine Business Associations Law, payable to all regular employees so as to distribute 0.25% of the net income of each year among them. An accrual for this expense has been recorded in the account "Other liabilities".

## **8. ENVIRONMENTAL MATTERS**

TGS's management believes that the Company's current operations are in substantial compliance with applicable laws and regulations relating to the protection of the environment. TGS's environmental policy is designed to comply with Argentine laws relating to hazardous waste and air quality. Under these laws, the principal hazardous substances generated by TGS consist of discarded casing oil, and those parts of the compressor station entry filters which are soaked in hydrocarbons.

TGS has implemented a policy of reducing and treating hazardous substances. Consequently, during 1995 the Company completed a study of all the emissions produced by TGS, including gaseous, liquid and solid emissions, with the objective of making a quantitative and qualitative evaluation. The study covered all the compressor plants and maintenance bases, as well as the Cerri Complex, and extended along nearly 6,000 km (3,728 miles) of gas pipeline. Based on the results of the study, minor farm land restoration was required, as well as construction of drainage systems and the installation of incinerators for the hazardous substances.

TGS's policy in connection with environmental affairs and industrial security is based on the Company's commitment to provide gas transportation and other related services observing the following principles:

- 1) Continuous improvement in operating standards to avoid accidents and pollution.
- 2) Fulfillment of provisions contained in the current legislation and procedures adopted by the Company.
- 3) Establishment of annual goals and objectives in accordance with this policy and the Company's vision, mission and values.
- 4) Personnel training in accordance with the responsibility and the risks involved in each job.

In October 1998, TGS obtained the certification of environmental management system, in accordance with the international standards ISO 14001.

## **9. LEGAL AND REGULATORY MATTERS**

- a) In April 1996, GdE filed a legal action seeking reimbursement from the Company of US\$ 23 million paid by GdE under purchase orders issued in connection with two compressor plants. The Company has recorded such plants as "Property, plant and equipment" valued at Ps. 4.8 million based on the replacement cost of similar compressor equipment. TGS has thoroughly answered the demand and is contesting the claim.
- b) As of the date of issuance of these financial statements, GdE directly or through ENARGAS, has not fulfilled the obligations set forth in the Transfer Agreement and in the License in connection with its responsibility for the five-year period ending on December 31, 1997, for the registering of easements relating to the transferred pipeline system which have not been properly registered and for related payments to property owners of any required easements. In order to fulfill its capital expenditures program related to the system integrity and public safety required by the License, the Company has entered into easement agreements with certain land owners and paid related amounts. Consequently, the Company filed a claim against GdE to recover such amounts paid.

On October 7, 1996, the Executive Branch, through Decree N° 1,136/96, created a contribution fund, as provided for in the License, to assume GdE's obligations for paying easements and any other compensation to land owners for an initial five-year period, beginning with the privatization and ending on December 28, 1997. ENARGAS manages the above mentioned fund, which is financed by a special charge included in the transportation rates and reimbursed to ENARGAS. TGS has filed against GdE-ENARGAS an administrative claim asking for the amounts paid in connection with easements related to facilities existing prior to December 28, 1992. At December 31, 1999 the Company has accrued approximately 4,200 in the account "Other current receivables" for this concept. In December 1997, ENARGAS declared that it will allow the reimbursement of the useful expenses, as determined by the Government, derived from easements. The Company expects to fully recover the amounts paid, based on its rights derived from the License.

In connection with the easements payable starting January 1, 1998, TGS is negotiating with the ENARGAS the recovery of amounts paid through increases in the transportation rates. As of December 31, 1999, the Company has accrued 6,444 for this concept in the account "Other non-current receivables". The Company expects, based on its rights, to fully recover the amounts paid.

- c) In 1997, the Company received a preliminary assessment from the Tax Bureau of the Neuquén Province related to stamp tax derived from transportation contracts entered into between TGS and four gas distribution companies shortly before the take-over date of TGS and while GdE was the sole shareholder of the Company. In December 1999, the Tax Bureau of the Neuquén Province formalized the claim through a final assessment for an amount of approximately Ps. 97 million (with its related interests as of December 31, 1999). Moreover, proceedings integration was set in order to evaluate eventual penalties application. TGS' management believes that these contracts were not subject to provincial stamp taxes because the parties to the contracts at the time they were formed, were governmental entities that were exempt from the tax. Moreover, even if the contracts were subject to provincial stamp taxes, management believes that GdE would bear responsibility for this tax under the Transfer Agreement. As regards the preliminary assessment, the Company has notified GdE of its position and has filed an appeal with the Tax Bureau of the Neuquén Province requesting that the relevant statute of limitations be enforced on the tax obligation claimed by such province. However, if the Company were forced to pay any amount, it would have the right to be reimbursed from GdE or the Argentine Government. The Argentine Government has recognized that is responsible for the payment of such tax. In connection with the final assessment received in December 1999, TGS filed an appeal to the Tax Bureau of the Neuquén Province.

In December 1998, TGS received another preliminary assessment from the Tax Bureau of the Neuquén Province in the amount of approximately Ps. 17 million related to the stamp tax (and related interests as of December 31, 1998) arising from the Transfer Agreement subscribed by TGS in the privatization of GdE. TGS management believes, as in the assessment described above, that this transfer was not subject to the stamp tax, as expressly defined in the first part of the above paragraph. However, if the Company were forced to pay any amount, it would have the right to be reimbursed by GdE or the Argentine Government. The Company has notified the Argentine Government of its position and proceeded to request that the relevant statute of limitations be enforced on the tax obligation. Additionally, TGS received another preliminary assessment from such Tax Bureau regarding the Technical Assistance Agreement. TGS has asserted that such tax is unfounded mainly because the agreement has no effects in such province.

In May 1999, TGS was notified of a preliminary assessment by the Tax Bureau of the Río Negro Province related to the stamp tax on transportation service offer letters received from shippers in the claimed amount of approximately Ps. 87 million plus Ps. 86 million of interests and Ps. 168 million as penalties. In September 1999, the Tax Bureau of the Río Negro Province formalized the claim through a final assessment. Additionally, TGS was notified in October 1999 of a preliminary assessment by the Tax Bureau of the Santa Cruz Province in connection with stamp tax to be levied on transportation service offer letters received from shippers, for an amount of approximately Ps. 17 million (not including interests nor penalties). The assessments of both provinces comprise transportation agreements entered into by TGS and several shippers, both before TGS take-over and when GdE was the sole shareholder of the Company, as well as the offer letters received after such date. TGS's management believes, as in the case of the Neuquén Province, that agreements prior to the take-over were not subject to the application of provincial stamp tax, since the subscribing parties belonged to the Argentine Government, which is exempt from the stamp tax. In addition, TGS' management believes that, even if the contracts signed before the take-over were subject to the stamp tax, GdE would be responsible for the payment of such tax, according to the Company Transfer Agreement provisions. If the Company were forced to pay any

amount arising from these agreements, it would have the right to be reimbursed by GdE or the Argentine Government.

In connection with the remaining assessments, the Company's management believes that offer letters for transportation service rendering are not subject to the tax mentioned above. Should they be taxable, TGS believes that such event must be considered a change in the interpretation of the tax law, and its impact should be reflected in the tariff according to regulations on the subject. ENARGAS believes that the claims for stamp tax lack of merit because it considers the tax unlawful.

The Company believes that all assessments in connection with agreements and offer letters prior to January 1, 1994 have been extinguished. The Company has notified GdE of its position and will appeal through an administrative motion within legal terms before the Tax Bureau of the Río Negro Province, which will pronounce judgement on the appeal. In regard to the preliminary assessment of the Tax Bureau of the Santa Cruz Province, TGS has notified GdE of its position and will file its appeal to such province entity. Furthermore, TGS filed a declaratory action of certainty before the Supreme Court of Justice ("SCJ"), so that such entity pronounces judgement on the legitimacy of the Santa Cruz Province Tax Bureau claim. In addition, until SCJ pronounces judgement on the issue, TGS requested a preventive measure from such entity.

d) In addition to the matters discussed above, the Company is a party to certain lawsuits and administrative proceedings arising in the ordinary course of business.

TGS management believes that the final outcome of the lawsuits and proceedings discussed above, based on the arguments described for each case, will not have a material adverse effect on the Company's financial position and results of operations.

Additionally, TGS requested to ENARGAS an adjustment to its gas transportation tariffs, as provided in the License, in order to recover through them the burden of the new tax on interest payments and financial costs established by Law N° 25,063. ENARGAS overruled the request on the grounds that it considers the above mentioned tax as similar to income tax (the only tax which can not be passed through to tariffs). TGS filed a subsidiary motion of review to the Federal Energy Bureau, which has not pronounced a resolution by the date of the issuance of these financial statements. As of December 31, 1999, "Net financial expense" includes 7,864 for such tax.

## 10. BALANCES AND TRANSACTIONS WITH RELATED COMPANIES

The principal recurrent transactions with related parties are payments under the Technical Assistance Agreement entered into with the technical operator, Enron Pipeline Company Argentina S.A. ("EPCA"), in compliance with the provisions of the Bid Package and the Transfer Contract, whereby EPCA is to provide technical advisory services which include services related to, among others, the operation of the gas transportation system, the gas processing facilities and related facilities and equipment, the replacement and renovation of facilities to ensure that the performance of the system is in conformity with international standards and compliance with the environmental standards. For these services the Company pays a monthly fee based on the higher of: a percentage of certain defined income of the Company or a specified fixed annual amount. The term of the contract is for eight years from December 28, 1992, and may be renewed upon expiration for additional eight-year periods.

The detail of significant outstanding balances for transactions with related companies as of December 31, 1999 and 1998 is as follows:

Company	1999		1998	
	Accounts receivable	Accounts payable	Accounts receivable	Accounts payable
EPCA	-	1,931	-	1,774
Perez Compañía S.A.	3,088	2,368	1,668	10,350 (1)
Enron International Argentina S.A.	655	102	-	793

SADE Ingeniería y Construcciones S.A. (2)	-	-	2,912	-
Total	3,743	4,401	4,580	12,917

- (1) Debt related with the acquisition of a gas compression and treatment plant located in the Río Neuquén gas field for an amount of 35,000.  
(2) Perez Companc S.A. sold this company in the first quarter of 1999.

The detail of significant transactions with related companies for the years ended December 31, 1999, 1998 and 1997 is as follows:

Company	Revenues				Constructions of property, plant and equipment
	Gas Transportation	Gas processing and other services	Salaries and wages	Compensation for technical assistance	
EPCA	-	-	891	22,238	-
Perez Companc S.A.	16,899	12,081	-	-	-
Enron International Argentina S.A.	3,496	96	-	-	-
SADE Ingeniería y Construcciones (1)	-	-	-	-	-
Total 1999	20,395	12,177	891	22,238	-
Total 1998	18,539	-	1,364	20,620	18,364
Total 1997	12,276	-	1,951	21,198	11,000

- (1) Perez Companc S.A. sold this company in the first quarter of 1999.

## 11. CONTROLLED COMPANIES

On September 29, 1998, TGS' Board of Directors approved the creation of TELCOSUR S.A., whose special purpose will be the rendering of telecommunication services, assuring the optimal utilization of TGS' telecommunication system. TGS' ownership interest in such company is 99.98% and the remainder 0.02% is held by EPCA. On October 22, 1998, the Governmental Regulatory Agency of Corporations approved the constitution of the company. On February 16, 1999, the regulatory agency (The Federal Communication Bureau) granted the license to TELCOSUR for rendering certain telecommunication services. As of December 31, 1999, TELCOSUR has not rendered any service.

## 12. SUMMARY OF SIGNIFICANT DIFFERENCES BETWEEN ACCOUNTING PRINCIPLES FOLLOWED BY THE COMPANY AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

The accompanying financial statements have been prepared in accordance with Argentine GAAP which differ in certain respects from those applicable in the United States of America ("US GAAP"). Accordingly, these financial statements are intended solely to present financial position, results of operations and cash flows in accordance with Argentine GAAP.

The significant differences between Argentine GAAP and US GAAP that affect the Company's financial statements are principally related to the following items:

### a) Restatement of financial statements for general price-level changes:

As described in Note 2.a) effective September 1, 1995, the restatement for inflation methodology was discontinued, maintaining the effects of inflation accounted for in prior periods. The discontinuance of inflation accounting is in compliance with Argentine GAAP, provided that the annual variation in the GLWPI does not exceed 8% per annum.

Under US GAAP, account balances and transactions are stated in the units of currency of the period when the transactions originated. This accounting model is commonly known as the historical cost basis of accounting. SEC rules establish that foreign private issuers that prepare their financial statements in a reporting currency that comprehensively includes the effects of price level changes are not required to eliminate such effects in the

reconciliation to US GAAP. Therefore, the US GAAP reconciliation of net income and shareholders' equity shown in paragraph i) does not reflect the effect of the general-price level restatement as a difference.

b) Income taxes:

Argentine GAAP income tax expense is based upon the estimated current income tax liability to the Argentine Tax Authority, "Administración Federal de Ingresos Públicos". When income and expense recognition for income tax purposes does not occur in the same period as income and expense recognition for financial statement purposes, the recording of the differences is not a common practice among Argentine corporations. Under US GAAP, Statement of Financial Accounting Standards ("SFAS") No. 109 "Accounting for Income Taxes" requires the liability method be used to account for deferred taxes. Under this method, deferred tax assets and liabilities are recorded based on anticipated tax consequences attributable to differences between financial statements carrying amounts of assets and liabilities and their respective tax bases. Under current Argentine tax regulations, the effects of inflation are not included in the determination of taxable income nor in the tax basis of assets or liabilities. Accordingly, the net deferred tax liability or asset included in the US GAAP reconciliation of net income and shareholders' equity shown in paragraph i) includes the effects of inflation on non monetary assets.

c) Intangible assets:

Under Argentine GAAP, organization and pre-operating costs (including costs associated with voluntary retirement programs) and cancellation costs of commitments assumed, incurred in the start-up of a privatized company, may be deferred and amortized over the resultant period of benefit. Under US GAAP such costs must be expensed as incurred.

d) Vacation accrual:

Under Argentine GAAP, there are no specific requirements governing the recognition of the accrual for vacations. The acceptable practice in Argentina is to charge vacations to expense when taken and to accrue only the amount of vacation in excess of the normal remuneration. Under US GAAP, vacation expense is fully accrued in the period the employee renders service to earn such vacation.

e) Valuation of property, plant and equipment:

Under Argentine GAAP transferred assets were valued as described in Note 2.h). Under US GAAP, Accounting Principles Board N° 16 "Business Combinations" provides the guidance for the valuation of property, plant and equipment in connection with an acquisition. As CIESA acquired 70% of the capital stock of TGS, the fixed assets transferred should have been valued at the price effectively paid for such 70%, plus the inflation adjusted historical cost carried by GdE for the remaining 30%. The condition of GdE's books and records, specifically that no separate financial statements or financial information was kept with respect to transportation operations or the operation of assets transferred to TGS, and the unavailability of any 1992 GdE financial information made it impossible to determine historical cost. TGS's management believes, based on information maintained by the Argentine Government Public Notary, that the fair value of the transferred assets recorded on its books was significantly below the 1991 GdE historical book values brought forward to 1992 and restated in constant Argentine pesos at the Transfer Date. Therefore, no adjustment has been recorded in the US GAAP reconciliation of net income and shareholders' equity shown in paragraph i) related to the valuation of property, plant and equipment.

For purposes of SFAS No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" measurement, TGS's management believes that estimates of future cash flows by group, based on reasonable assumptions that represent the best estimate of the cash flows expected to result from their use, show that no impairment loss has to be recognized.

f) Depreciation of pipeline system assets:

Under Argentine GAAP, the pipeline system assets are depreciated on a basis of 67 years useful life, as described in Note 2.h).

Under US GAAP, the useful life generally cannot exceed the License period (35 years plus a 10-year extension). Furthermore, US GAAP requires that the depreciable amount of an asset should be determined after deducting its salvage value. Given the compensation mechanism defined in the License for the pipeline system assets mentioned in Note 6.c), TGS' management estimates that the net book value calculated under the License terms at the end of 45th year would be lower than the estimated proceeds from a new competitive bidding for TGS gas transportation business. Accordingly, such net book value at the 45th year is considered as the salvage value which would be recovered by TGS if License period was not extended. This results in the depreciation charge under Argentine GAAP equaling the depreciation charge which would have resulted if the Company had reduced the depreciable value of the pipeline system assets by the estimated salvage value and depreciated the remainder over the term of the License.

g) Hedge of anticipated transaction:

As described in Note 5, TGS entered into a hedge transaction which locked in the rate of an anticipated 5-year maturity debt raising to refinance the first issuance of US\$ 200 million under the 1993 Global Program. According to SFAS No. 80 "Accounting for Futures Contracts" ("SFAS 80") results generated by the hedges of anticipated transactions can be deferred over the term of such transactions provided that all of the following conditions are met: (i) the item to be hedged exposes the Company to interest rate risk, (ii) the derivative reduces that risk and is designated as a hedge at the inception, (iii) the significant characteristics and expected terms of the anticipated transaction are identified, including the expected date of the transaction, and (iv) it is probable that the anticipated transaction will occur.

TGS failed to make the 5-year debt issuance at the expected date. Consequently, under the restrictive criteria of SFAS 80, hedge accounting was terminated and mark-to-market accounting was applied at December 31, 1998. Under Argentine GAAP there are no specific requirements governing hedge accounting and the Company followed the criteria described in Note 5. Therefore, the US GAAP reconciliation of the Company's net income and shareholders' equity, shown in paragraph i) below, reflects the impact of the strict accounting criteria adopted by SFAS 80.

h) Adoption of SFAS No. 133:

In June 1998, the Financial Accounting Standards Board ("FASB") issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", effective for fiscal years beginning after June 15, 1999. This Statement establishes accounting and reporting standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded in the balance sheet as either an asset or liability measured at its fair value. The Statement requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative's gains and losses to offset related results on the hedged item in the income statement, and requires that a company must formally document, designate, and assess the effectiveness of transactions that receive hedge accounting.

In June 1999, the FASB approved SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities-Deferral of the Effective Date of SFAS No. 133", which amends SFAS No. 133's effective date. SFAS No. 133 will now be effective for all fiscal quarters of all fiscal years beginning after June 15, 2000 (that is, January 1, 2001 for TGS). The SFAS No. 133 cannot be applied retroactively. The Company has not yet quantified the impacts of adopting SFAS No. 133 on its US GAAP reconciliation of net income and shareholders' equity shown in paragraph i).

Under Argentine GAAP, there are no specific requirements governing the financial instruments accounting. The Company's derivative financial instruments were accounted for as described in Note 2.b) and Note 5.

i) Reconciliation of Net Income and Shareholders' Equity to US GAAP:

The following is a summary of the significant adjustments to net income for the years ended December 31, 1999, 1998 and 1997 and to shareholders' equity as of December 31, 1999 and 1998 which would be required if US GAAP were applied instead of Argentine GAAP in the accompanying financial statements.

	<u>1999</u>	<u>1998</u>	<u>1997</u>
<b>Net income in accordance with Argentine GAAP</b> .....	145,724	156,482	167,985
US GAAP adjustments- Increases (decreases) due to:			
Additions, amortizations and retirements of intangible assets .....	1,195	938	527
Provision for vacation accrual.....	517	344	(533)
Hedge of anticipated transaction.....	5,408	(8,112)	—
Deferred income taxes .....	<u>(7,488)</u>	<u>(8,071)</u>	<u>(4,043)</u>
<b>Approximate net income in accordance with US GAAP</b> .....	<u>145,356</u>	<u>141,581</u>	<u>163,936</u>

Earnings per share:

Amounts per accompanying financial statements.....	0.18	0.20	0.21
Approximate amounts under US GAAP .....	0.18	0.18	0.21

Earnings per ADS:

Amounts per accompanying financial statements.....	0.92	0.98	1.06
Approximate amounts under US GAAP .....	0.91	0.89	1.03

	<u>1999</u>	<u>1998</u>
<b>Shareholders' equity in accordance with Argentine GAAP</b> .....	1,057,464	1,070,639
US GAAP adjustments- Decreases due to:		
Intangible assets charged to operations .....	(25,330)	(26,525)
Hedge of anticipated transaction .....	(2,704)	(8,112)
Provision for vacation accrual .....	(1,898)	(2,415)
Deferred income taxes .....	<u>(76,111)</u>	<u>(68,623)</u>
<b>Approximate shareholders' equity in accordance with US GAAP</b> .	<u>951,421</u>	<u>964,964</u>

j) Additional significant US GAAP disclosures:

1) Deferred income taxes:

The following table presents the components of the Company's deferred income tax balances:

	<u>1999</u>	<u>1998</u>
<b>Deferred tax assets</b>		
Vacation accrual .....	664	845
Hedge of anticipated transaction .....	946	2,839
	<u>1,610</u>	<u>3,684</u>
<b>Deferred tax liabilities</b>		
Difference between tax and accounting basis of:		
Property, plant and equipment .....	75,327	70,145
Intangible assets and debt issuance costs .....	1,233	2,162
Deferred revenues .....	1,161	-
	<u>77,721</u>	<u>72,307</u>
Net deferred tax liability .....	<u>(76,111)</u>	<u>(68,623)</u>

Income tax computed at the statutory tax rate (35% in both 1999 and 1998 and 33% in 1997) on pre-tax income differs from the income tax expense for the years ended December 31, 1999, 1998 and 1997 computed in accordance with US GAAP as follows:

	<u>1999</u>	<u>1998</u>	<u>1997</u>
Income tax at statutory tax rate on pre-tax income in accordance with US GAAP .....	76,861	78,226	80,900
Change in statutory tax rate .....	—	3,669	—
Others, not individually significant .....	<u>(2,615)</u>	<u>27</u>	<u>314</u>
Approximate income tax expense under US GAAP ..	<u>74,246</u>	<u>81,922</u>	<u>81,214</u>

2) Disclosures about fair value of financial instruments:

The following disclosure of the estimated fair value of financial instruments is presented in accordance with the requirements of SFAS No. 107 "Disclosure about Fair Value of Financial Instruments". The estimated fair value amounts have been determined by the Company using available market information and valuation methodologies.

As of December 31, 1999 and 1998, the carrying amounts of certain financial instruments used by the Company including cash, cash equivalents, receivables, payables and short term loans, except for the second issuance under the 1996 Global Program, are representative of fair value because of the short term maturity of these instruments. The estimated fair value of other non-current assets do not differ significantly from the carrying amount. The estimated fair value of long term debt is based on quoted market prices for the same or similar issues or on current rates available to TGS for debt of the same remaining maturities and is representative of its carrying amounts, except for the first issuance under the 1996 Global Program, the third issuance under the 1993 Global Program and the IDB loans. The fair value of the derivative financial instruments is the estimated amount at which management believes they could be liquidated based on current market conditions or other estimates as quoted market prices obtained from third-party dealers.

The following table reflects the carrying amount and estimated fair value of the Company's financial instruments at December 31, 1999 and 1998:

	1999		1998	
	Carrying amount	Fair value	Carrying amount	Fair value
<b>Balance Sheet financial instruments</b>				
(in millions of US\$)				
<u>Debt:</u>				
First issuance under the 1996 Global Program	151.1	152.8	151.9	150.8
Third issuance under the 1993 Global Program	99.6	92.4	99.4	87.2
Second issuance under the 1996 Global Program	200.5	201.2	—	—
IDB loans	321.6	325.4	—	—
<b>Derivative financial instruments</b>				
<u>Non trading:</u>				
Interest rate swap agreements	(0.1)	(0.5)	0.1	(2.3)
Foreign currency futures	0.5	(2.0)	0.4	1.5
Interest rate locks	—	—	—	(15.9)

Credit risk relates to the risk of loss that the Company would incur as a result of non performance by counterparties. Pursuant to the terms of their contractual obligations it is related to the ability of the counterparties to meet the term of the contracts. However, counterparties associated with interest rate swaps and locks are investment grade financial institutions and, accordingly, the Company does not anticipate non-performance by such third-parties.

### **13. OTHER FINANCIAL STATEMENT INFORMATION**

The following tables present additional financial statement disclosures required under Argentine GAAP. This information is not required as part of the financial statements under US GAAP, however, certain of these tables substantially duplicate the schedule requirements of the SEC.

- a) Property, plant and equipment
- b) Intangible assets
- c) Investments
- d) Foreign currency assets and liabilities
- e) Expenses incurred
- f) Detail of maturities of cash investments, receivables and liabilities

### **14. SUBSEQUENT EVENTS**

On January 24, 2000, the Company was again requested by ENARGAS not to apply the reestimated useful life of the assets allocated to the gas transportation system, described in Note 2.h), notwithstanding the continuance of administrative procedures and subject to the beginning of the duly disciplinary proceedings. The Company's management believes that this new ENARGAS' request does not modify its position in connection with the reasonability of the reestimation of the useful life. The Company is currently evaluating different ways of action before the proper authorities. If TGS were finally obliged to change the reestimation of the useful life mentioned above, the Company believes it would modify the depreciation charge prospectively and therefore the Company does not expect any significant impact on its financial condition and results of operations for the year ended December 31, 1999.

i) Property, plant and equipment:

Main Account	1999					1998					1997		
	Original Cost					Depreciation					Net book value		
	Beginning of year	Additions	Retirements	Transfers	End of year	Accumulated at beginning of year	Retirements	Expenses for the year		Accumulated at the end of year	Net book value	Net book value	Net book value
								Amount	Rate %				
Real property	55.077	-	47	972	56.002	8.343	6	1.183	1.5 to 5.9	9.520	46.482	46.734	46.507
Assets related to the gas transportation service	1.582.492	-	131	177.809	1.760.170	151.151	131	22.858 (2)	1.5	173.878	1.586.292	1.431.341	1.374.096
Assets related to the gas upstream service	43.097	-	-	175	43.272	1.401	-	3.223	1.5 to 33.3	4.624	38.648	41.696	5.034
Assets related to the gas processing service	199.647	-	-	6.245	205.892	33.433	-	10.058 (2)	5.9	43.491	162.401	166.214	86.784
Vehicles	16.145	1.154	451	-	16.848	8.080	393	1.729	6.7 to 50	9.416	7.432	8.065	9.264
Furniture, hardware, software and industrial tools	30.583	149	-	4.855	35.587	14.637	-	5.839	11.5 and 20	20.476	15.111	15.946	10.942
Subtotal	1.927.041	1.303	629	190.056	2.117.771	217.045	530	44.890		261.405	1.856.366	1.709.996	1.532.627
Line pack	5.444	118	-	-	5.562	660	-	74 (2)	1.5	734	4.828	4.784	4.772
Work in progress	95.434	141.217	-	-180.585	56.066 (1)	-	-	-	-	-	56.066	95.434	129.718
Materials	37.808	4.456	280	-9.471	32.513	-	-	-	-	-	32.513	37.808	37.052
Total 1999	<u>2.065.727</u>	<u>147.094</u>	<u>909</u>	<u>-</u>	<u>2.211.912</u>	<u>217.705</u>	<u>530</u>	<u>44.964</u>		<u>262.139</u>	<u>1.949.773</u>		
Total 1998	<u>1.887.119</u>	<u>183.481</u>	<u>4.873</u>	<u>-</u>	<u>2.065.727</u>	<u>182.950</u>	<u>2.046</u>	<u>36.801</u>		<u>217.705</u>		<u>1.848.022</u>	
Total 1997	<u>1.716.251</u>	<u>178.384</u>	<u>7.516</u>	<u>-</u>	<u>1.887.119</u>	<u>137.935</u>	<u>1.327</u>	<u>46.342</u>		<u>182.950</u>			<u>1.704.169</u>

1) Includes advances to suppliers for 5,885.

2) See Note 2.h).

3) Amounts in the table above reflect certain reclassifications in 1997, for comparative purposes with the 1999 and 1998 amounts.

b) Intangible assets:

DEFERRED CHARGES	1999							1998	1997	
	Original Cost			Accumulated at beginning of year	Amortization		Accumulated at the end of year	Net book value	Net book value	Net book value
	Beginning of year	Additions	End of year		Expenses for the year					
				Amount	Rate %					
Organization, pre-operating costs, cancellation costs of commitments assumed under the Transfer Contract and other costs	##	32,089	-	32,089	5,564	1.195 (3) 2.8 and 20	6,759	25,330	26,525	27,463
Cost of setting up the 1993 Global Program and the First issuance of Medium Term Notes thereunder	##	-	-	-	-	-	-	-	-	583
Settlement costs of hedges of anticipated transactions	##	-	19,201	19,201	-	6.275 ## -5	6,275	12,926	-	-
Total 1999		<u>32,089</u>	<u>19,201</u>	<u>51,290</u>	<u>5,564</u>	<u>7,470</u>	<u>13,034</u>	<u>38,256</u>		
Total 1998		<u>34,810</u>	<u>272</u>	<u>35,082</u>	<u>6,764</u>	<u>1,793</u>	<u>8,557</u>	<u>26,525</u>		
Total 1997		<u>34,467</u>	<u>343</u>	<u>34,810</u>	<u>5,295</u>	<u>1,469</u>	<u>6,764</u>			<u>28,046</u>

(1) Includes the cost of the Voluntary Retirement Program of 1993, accepted by 463 employees, for approximately 12,122.

(2) See Note 5.

(3) Included in "Other expenses, net".

(4) See Note 2.1).

(5) See Note 2.1).

c) Investments:

	1999		1998
	Cost Adjusted for inflation	Book Value	Book Value
<b>CURRENT INVESTMENTS</b>			
Bank deposits in local currency	14.694	14.694	15.556
Bank deposits in foreign currency	36.360	36.360	36.173
Total current investments	51.054	51.054	51.729

d) Foreign currency assets and liabilities:

<u>ACCOUNT</u>	1999			1998		
	Foreign currency and amount (in thousands)	Exchange rate	Amount in local currency	Foreign currency and amount (in thousands)	Amount in local currency	
<b>CURRENT ASSETS</b>						
Cash	US\$	9.864	1.00 (1)	9.864	US\$	160
Investments	US\$	36.360	1.00 (1)	36.360	US\$	36.173
Trade receivables	US\$	6.662	1.00 (1)	6.662	US\$	3.330
Other receivables	US\$	29	1.00 (1)	<u>29</u>	US\$	<u>538</u>
				52.915		40.201
<b>NON-CURRENT ASSETS</b>						
Trade receivables	US\$	9.085	1.00 (1)	9.085	-	-
Property, plant and equipment - work in progress						
Advances to suppliers	US\$	597	1.00 (1)	597	US\$	6.516
	EUR	732	1.02 (1)	<u>748</u>	-	<u>-</u>
				<u>10.430</u>		<u>6.516</u>
				<u>63.345</u>		<u>46.717</u>
<b>CURRENT LIABILITIES</b>						
Accounts payable	US\$	15.501	1,00 (2)	15.501	US\$	22.501
Loans	US\$	398.031	1,00 (2) (3)	<u>398.031</u>	US\$	<u>233.067</u>
				413.532		255.568
<b>NON-CURRENT LIABILITIES</b>						
Loans	US\$	599.702	1,00 (2)	<u>599.702</u>	US\$	<u>616.557</u>
				<u>1.013.234</u>		<u>872.125</u>

(1) Buying exchange rate.

(2) Selling exchange rate.

(3) See Note 5. "Other bank borrowings".

e) Expenses incurred:

<u>Account</u>	1999				1998	1997
	<u>Operating costs</u>	<u>Administrative expenses</u>	<u>Selling expenses</u>	<u>Total</u>	<u>Total</u>	<u>Total</u>
Compensation to Directors and Statutory Audit Committee	-	180	-	180	180	180
Salaries, wages and other contributions	14.415	5.435	1.293	21.143	22.035	24.455
Social security taxes	2.750	1.401	276	4.427	4.685	4.846
Other employee benefits	1.175	1.169	130	2.474	2.416	2.865
Depreciation of property, plant and equipment	42.317	2.647	-	44.964	36.801	46.342
Operating expenses, materials, supplies and repairs	19.228	2.152	89	21.469	15.525	13.971
Technical assistance, licensee, and other fees	26.566	2.102	126	28.794	22.542	22.700
Insurance	1.838	177	-	2.015	1.974	2.160
Taxes and contributions	1.762	93	-	1.855	3.567	1.050
General expenses	<u>776</u>	<u>1.634</u>	<u>80</u>	<u>2.490</u>	<u>2.535</u>	<u>2.787</u>
Total 1999	<u><u>110.827</u></u>	<u><u>16.990</u></u>	<u><u>1.994</u></u>	<u><u>129.811</u></u>		
Total 1998	<u><u>93.581</u></u>	<u><u>16.934</u></u>	<u><u>1.745</u></u>		<u><u>112.260</u></u>	
Total 1997	<u><u>103.902</u></u>	<u><u>15.461</u></u>	<u><u>1.993</u></u>			<u><u>121.356</u></u>

f) Detail of maturities of cash investments, receivables and liabilities:

	<u>Cash</u> <u>investments (1)</u>	<u>Receivables (2)</u>	<u>Debt (3)</u>	<u>Other</u> <u>liabilities (4)</u>
<u>Without specified maturity</u>	-	10.768	-	4.290
<u>With specified maturity</u>				
* Past due				
From 10-01-99 to 12-31-99	-	7.165	-	-
From 07-01-99 to 09-30-99	-	374	-	-
From 04-01-99 to 06-30-99	-	421	-	-
From 01-01-99 to 03-31-99	-	285	-	-
Until 12-31-98	-	1.611	-	-
<b>Total past due</b>	<u>-</u>	<u>9.856</u>	<u>-</u>	<u>-</u>
* Non-due				
From 01-01-00 to 03-31-00	51.054	50.399	182.456	72.055
From 04-01-00 to 06-30-00	-	138	213.730	3.622
From 07-01-00 to 09-30-00	-	-	3.781	-
From 10-01-00 to 12-31-00	-	146	1.085	-
During 2001	-	3.044	158.632	-
During 2002	-	351	107.990	-
During 2003	-	391	6.655	-
During 2004	-	436	47.644	-
During 2005	-	485	44.269	-
During 2006	-	540	43.502	-
From 2007 onwards	-	6.569	195.599	-
<b>Total non-due</b>	<u>51.054</u>	<u>62.499</u>	<u>1.005.343</u>	<u>75.677</u>
<b>Total with specified maturity</b>	<u>51.054</u>	<u>72.355</u>	<u>1.005.343</u>	<u>75.677</u>
<b>Total</b>	<u><u>51.054</u></u>	<u><u>83.123</u></u>	<u><u>1.005.343</u></u>	<u><u>79.967</u></u>

(1) Includes bank deposits which bear fixed rate interests.

(2) Includes trade and other receivables which bear no interest, except by approximately 11% which bears interests at 5.52% annual interest rate.

(3) Includes loans excluding debt issuance discounts, the cash received from the contract settlement of the Treasury lock related to the First Issuance of debt notes under the 1996 Global Program and up front fees. Considering the swap agreements (see Note 5), approximately 74% of the outstanding principal debt bears fixed rate interests.

(4) Includes liabilities other than debt, which bear no interest.