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Global Energy Industry Review

3 The Iraqi Oil Industry—Back on Track?

5 Scaling Up Sustainable Investments: Solar Power and Feed-in Tariffs in the United Kingdom

9 The Potential Impact of Dodd-Frank on the Energy Industry

13 UK—Updated Prospectus Content Recommendations for Mineral Companies

15 Natural Gas In Brazil

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In this edition of Mayer Brown's *Global Energy Review*, we examine Brazil's Natural Gas Law to regulate the natural gas industry in Brazil—though signed in 2009 the law was only recently implemented and deemed enforceable by the president of Brazil. We also take a second look at the Iraqi oil industry and examine the progress in government relations between Iraq and Kurdistan.

Within Europe, we examine how the revised CESR recommendations will affect mineral companies. We also explore feed-in tariffs in the United Kingdom and how they will be the driver in government's strategy to produce 15 percent of its energy supply from renewable sources by 2020.

In the United States, Dodd-Frank continues to evolve. We delve into the Dodd-Frank Act and outline its potential impact on energy companies.

While this review is intended to look at trends in the energy industry, we regularly publish legal updates on timely issues. To view a complete list of our energy updates visit our Energy News and Publication page. ◆

The Iraqi Oil Industry—Back on Track?

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In our Summer 2010 issue of *Global Energy Industry Review*, we reflected on the vast oil and gas potential of Iraq, home to the world's fourth largest oil reserves. In particular, we considered the obstacles faced by the Kurdistan Regional Government (KRG), in the north of the country, to establish a strong, investor-friendly oil and gas regime in Kurdistan in the face of an ongoing dispute with the Iraqi federal government in Baghdad. The main point of contention was the production sharing contracts (PSCs) entered into between the KRG and foreign investors, with Baghdad labelling these as "illegal and illegitimate" and imposing a ban on oil exports from the region. This has caused significant uncertainty over whether the international oil companies would recoup their investments. The full article, "Exploration and Production of Oil and Gas in Kurdistan," is available at http://www.mayerbrown.com/publications/article.asp?id=9408&nid=6.

Now, almost one year later, we wonder what, if anything, has changed?

The recent signs appear to be positive. In January 2011, the KRG announced that, following meetings in Baghdad with the Iraqi federal government, oil exports from Kurdistan would resume on February 1, 2011. Currently an estimated 100,000 barrels of oil per day are being exported from Kurdistan's two producing fields, Tawke and Taq Taq, through the 600-mile long pipeline to the Mediterranean oil terminal at Ceyhan in Turkey. Significantly the key issue of payments to contractors for this oil, and whether these payments are made from the KRG's share of oil or Baghdad's, remains unresolved, yet clearly the resumption of exports is a step in the right direction.

New entrants have continued to flock to Kurdistan, most recently the independents Marathon Oil and Murphy Oil. This confirms that, despite the political impasse, the oil-rich region still holds growing appeal for international investors encouraged by the relative stability, on-shore environment and generous PSC terms offered by the KRG. There are now more than 40 international oil companies in the region and, as hopes increase for a resolution to the dispute over the PSCs, that number is set to grow.

Recent statements from Baghdad about Kurdistan have also been more conciliatory. Following the January meeting there were reports that the federal government was finally prepared to accept the terms of the PSCs, with Iraq's prime minister Nouri Al-Maliki citing the more challenging drilling conditions in the region, and the exploration-risk associated with the

relative infancy of the industry there, as valid reasons for the more generous terms granted to foreign contractors. The investment community awaits a formal announcement of an agreement between Baghdad and Erbil, particularly on the sensitive issue of reimbursement of contractors' costs, but with oil flowing again and the parties in discussions, the signs are encouraging.

Meanwhile the oil industry in the south of Iraq, for so long crippled by a succession of wars and international sanctions, continues to re-establish itself. Between June 2009 and February 2010 the Iraqi Oil Ministry tendered for the award of technical service contracts (TSAs) to develop Iraq's existing oil fields, some of which have production histories going back decades in contrast to the relative infancy of the industry in Kurdistan.

Many potential bidders balked at the tough terms offered by the TSAs, which, unlike the Kurdish PSC model, offer the contractor a cash fee per barrel of oil rather than a percentage share of physical oil. However, the quid pro quo was the huge proven resources available and the corresponding lack of exploration risk for the contractors. These promised benefits have proven truthful as the Iraq oil ministry recently announced a record increase in output from the fields, including a 10 percent rise in BP's production against its budgeted targets in the Rumaila field.

The newly appointed Iraq oil minister, Abdul Karim Al-Luaibi, has also given fresh impetus to the oil industry in the country. Reports suggest he has played an important role in the thawing of relations between Baghdad and the KRG. With the existing fields successfully back on stream in the South, Al-Luaibi has announced a further licensing round for new concessions. Importantly, these are for exploratory fields, and potential bidders will wait keenly on an announcement of the contract terms on offer. Given the element of exploratory risk, the TSA model would not appear to be appropriate, so something in between the TSA and the more generous PSC model seems likely.

Al-Luaibi has also recognised the importance of upgrading Iraq's infrastructure, in particular its old and eroded pipelines. Iraq's state-run South Oil Company is currently holding talks with BP, China National Petroleum Corporation and Eni to build three new pipelines worth up to $500 million. These would link the key Rumaila North, Tuba and Nahr Ben Umar fields with oil deposits in the Faw peninsula, where crude oil is then shipped via the sea terminals in the Gulf. A new pipeline will also be built to neighbouring Jordan and discussions are ongoing for a similar project into Syria.

So amid all these signs of progress, what are the notes of caution for foreign investors in Iraq? While the security environment in the country has improved significantly since the US military surge of 2007, the recent attack on the Baiji refinery, which forced Iraq's largest oil refinery to suspend operations, highlights a growing risk of targeted violence against the oil industry. The lack of transportation facilities and storage capacity for oil remains a problem, and the long-awaited federal oil and gas law is yet to be enacted, prolonging tensions between the differing oil regimes in Kurdistan and the rest of Iraq.

Given the low margins on offer under the TSAs, only the very largest companies have the economies of scale to successfully operate and stay competitive in the fields in southern Iraq. Meanwhile, the smaller independents in Kurdistan continue to suffer from the lack of clarity over payment mechanisms for exports from the region. Norway's DNO International, operator of the Tawke field in Kurdistan, reputedly is owed more than $400 million in unpaid revenue. Although some companies have the financial means to survive these conditions, others will be in a perilous condition if the dispute is not resolved in the near future.

The form of contracts offered in the new bidding round in the south will be significant. If, as is widely expected, the impasse over the Kurdish PSCs is resolved and a federal oil and gas law is enacted, we can expect a renewed scramble for concessions in Kurdistan, with some of the smaller contractors likely to become targets for the majors who have up until now been barred from entering the region due the their presence in southern Iraq. International oil companies, large and small, will be monitoring events in Iraq closely over the coming months. ◆

Scaling Up Sustainable Investments: Solar Power and Feed-in Tariffs in the United Kingdom

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Background

In April 2010, the UK government introduced a feed-in tariffs (FiTs) scheme as part of a drive to stimulate the development of renewable energy in the United Kingdom by incentivising businesses to invest in renewable technology. The FiTs scheme forms part of a wider government strategy designed to ensure that the United Kingdom meets its commitment to produce 15 percent of its energy supply from renewable sources by 2020, an obligation arising under the EU Renewable Energy Directive.

Tariff-based schemes have been around for some time, with countries including Germany, France, Australia and the United States using tariffs as financial incentives to encourage development of low-carbon electricity generation. In 2002, the United Kingdom followed suit, introducing the market-based Renewables Obligation Scheme (RO), which was designed to encourage deployment of large-scale renewable electricity generation.

Since its introduction almost a decade ago, the RO has trebled certain types of renewable electricity generation in the United Kingdom, from 1.8 percent to 5.3 percent. However, the complex system of financial support available under the RO has caused it to become a tool utilised only by large-scale generators. Its failings eventually brought pressure on the government to introduce a separate, simpler incentive system capable of broader application.

The FiTs scheme, which focuses on encouraging the installation of small-scale renewable energy technology, represents a change in the United Kingdom's approach to tariff-based incentives. It is aimed at organisations, businesses, communities and individuals who are not traditionally engaged in the electricity market and is similar in design to schemes successfully implemented in a number of continental EU Member States.

Under the FiTs scheme, operators of accredited small-scale installations that generate electricity using certain low-carbon energy sources are entitled to a guaranteed payment for each kilowatt hour (kWh) of electricity generated. The payment varies in line with a guaranteed minimum price, indexed at the retail prices index (RPI) for between 20 and 25 years, depending on the type of technology used.

Between April 1, 2010, and December 31, 2010, 18,464 installations, representing 68 megawatts (MW) of total installed capacity, had been registered with the Office of the Gas and Electricity Markets (Ofgem), the administrator of the FiTs scheme. The first quarter of 2011 has seen a rapid increase in the number of registrations, with over 30,000 installations now eligible to receive payments under the FiTs scheme.

In this article, we consider how FiTs work and identify the steps that should be taken by businesses seeking to benefit from participation in the FiTs scheme.

FiTs in Operation

FITS-ELIGIBLE INSTALLATIONS

Electricity suppliers in England, Wales and Scotland that have a minimum of 50,000 domestic customers are required to offer FiTs to all Ofgem-accredited small-scale installations (i.e., those with a generating capacity of up to five MW) generating electricity from specified renewable sources. Relevant sources of renewable energy include solar photovoltaic (PV), wind, hydro and anaerobic digestion. In addition, 30,000 installations (with up to two kW capacity) utilising non-renewable micro Combined Heat and Power (mCHP) technologies are included as a trial.

TYPES OF FITS PAYMENTS

Generators operating installations accredited under the scheme are eligible to receive two different types of FiTs payments:

- A fixed payment for every kilowatt hour (kWh) of electricity generated (the "Generation Tariff")
- A guaranteed minimum payment for every kWh of electricity exported to the national electricity grid (the "Export Tariff")

THE GENERATION TARIFF

The Generation Tariff is payable for all electricity produced by accredited installations from renewable sources. The tariff applies whether the electricity is used on-site or exported to the wider electricity market.

The applicable Generation Tariff differs depending on which renewable source is utilised. For example, the Generation Tariff paid for electricity generated in the second scheme year from solar PV is set between 29.3p per kWh and 41.3p per kWh, depending on the size of the installation. The Generation Tariff on electricity generated during the same period from anaerobic digestion is between 9p and 11.5p per kWh.

THE EXPORT TARIFF

Unlike the Generation Tariff, the Export Tariff rate is not dependent on the type of renewable source utilised or on the size of the accredited installation.

The Export Tariff is currently set at 3p per kWh (which represents a reduction from the initial proposed rate of 5p per kWh). The Export Tariff is intended to incentivise energy-efficient behaviour in the use of electricity generated from renewable sources by providing financial rewards to those who export electricity from accredited installations to the wider grid.

TARIFF LEVELS GOING FORWARD

As increased development occurs, the costs associated with renewable technologies are falling. As a result, the FiTs scheme makes provision for applicable tariff levels to be adjusted downwards through a process of degression. It is currently proposed that degression for many solar PV projects will begin in April 2012.

Implementing FiTs Across a Business Portfolio

FiTs were initially seen as a mechanism to encourage development of renewable energy technologies on a small scale by organisations, communities and individuals. A great deal of interest in FiTs, however, has been shown by large businesses in the United Kingdom that see the opportunity to install small-scale installations across multiple sites as a means of scaling-up their green investment and boosting their low-carbon credentials.

Businesses seeking to maximise benefits through development of installations across a portfolio must go through the following three distinct stages to achieve accreditation under the FiTs scheme:

STAGE 1

Feasibility Assessment

- Legal
- Technical/Commercial
- Planning

STAGE 2

Consents

- Planning/Zoning
- Third party consents: legal/connection
- Accreditation

STAGE 3

Implementation

- Design specification
- Procurement
- Project management

FEASIBILITY

Businesses that wish to leverage the FiTs scheme should start by investigating the feasibility of developing accredited installations. Their investigations should incorporate technical, legal and planning/zoning assessments in order to identify the best opportunities in a portfolio. Technical investigations should include, for example, identification of suitable roof space on which to install solar PV, as well as consideration of appropriate geographical locations for development to ensure maximum benefit from weather-dependent sources.

Businesses will also need to determine whether there are any legal restrictions in place that would prevent them from installing renewable technology. Relevant restrictions might include, for example, planning/zoning issues that may restrict the development of installations on a particular site. In addition, the practicalities of connecting installations to the wider grid and the need to undertake structural surveys to ensure building feasibility are important considerations. These and other issues may have cost implications that influence the decision of whether or not to proceed with a development on a particular site.

CONSENT

If a feasibility study indicates that development of accredited installations is viable, the business will need to take steps to obtain any consents that may be required to proceed. In the United Kingdom, planning/zoning permissions may be required from the local authority. Before relevant permissions are granted, the local authority may require the business to undertake an assessment of the visual or ecological impact an installation may have on the surrounding area, as well as an assessment of the likely effect the development may have on local heritage.

In addition to regulatory consents, legal documentation, including real estate, connection and off-take agreements, will need to be put in place. This will ensure that any consents required from third parties such as landlords and suppliers are documented appropriately.

IMPLEMENTATION

The final stage in the FiTs-accreditation process is the development of the installation itself. To qualify for FiTs, a business must engage a contractor with accreditation under the Microgeneration Certification Scheme (MCS) to install the necessary technology.

Once installation is complete, the accredited contractor will complete an MCS certificate for the installation that serves as proof of the installation's eligibility for FiTs.

Recent Developments

As part of the 2010 Spending Review setting out the British government's deficit reduction framework, the government announced its commitment to improving the efficiency of the FiTs scheme. In the context of this commitment, the government commenced the first comprehensive review of the FiTs scheme, a process that was originally scheduled to take place in 2012. The review will include a government consultation and is designed to cover all aspects of the scheme, including:

- Tariff rates
- Degression rates and methods
- Eligible technologies
- Arrangements for exports
- Administrative and regulatory arrangements
- Interaction with other climate change policies
- Accreditation and certification issues

The government has indicated its belief that implementing this review a year earlier than planned will help to provide certainty for the industry. This is especially critical in terms of clarifying how the planned savings set out in the Spending Review (which amount to around 10 percent of FiTs costs in the 2014–2015 financial year) are to be achieved.

The government also recently announced proposed reforms to tariff payments for installations over 50kW. These reforms, if implemented, will lead to the following new tariff bands and associated tariff rates being introduced for solar PV projects on August 1, 2011:

- 19p per kW hour for 50kW to 150kW projects
- 15p per kW hour for 150kW to 250kW projects
- 8.5p per kW hour for 250kW to 5MW and stand-alone projects

The Future of FiTs in the United Kingdom

The government's plans to reduce public spending have meant that reductions in FiTs rates were somewhat inevitable. However, the level of reductions for large installations was greater than many commentators had predicted, leading to an angry reaction from the renewable energy industry and the possibility of future litigation should the proposed reforms be approved by Parliament.

Undoubtedly, these reforms are aimed at curbing large solar farms. However, businesses willing to invest in smaller-scale retrofit projects, perhaps across a large number of sites, will continue to benefit from the generous tariff rates afforded to those installations.

The guaranteed payment available through the Generation Tariff and the guaranteed price for electricity conveyed onto the electricity grid through the Export Tariff are expected to continue to incentivise development of eligible installations in the United Kingdom.

These rewards, set against the backdrop of higher energy bills resulting from ever-increasing oil and gas prices, mean that the financial incentive to invest in renewables technologies remains high. This is particularly true when businesses invest in the development of small-scale installations across large property portfolios. ◆

The Potential Impact of Dodd-Frank on the Energy Industry

Paul J. Astolfi
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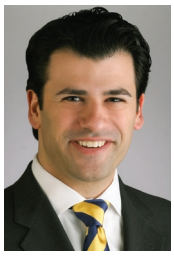

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In a dramatic demonstration of Congressional "Fire, Ready, Aim" and fully six-months before the scheduled report of the specially-charged Financial Crisis Investigation Commission, President Obama signed the Dodd-Frank Act[1] into law in July last year. While nominally addressing perceived causes of the recent financial crisis, the Dodd-Frank Act is a sprawling piece of legislation, directed at literally hundreds of different aspects of the financial system. The full text of the Act itself runs to nearly 850 pages, including 17 separate Titles, and has eleven pages of single-spaced table of contents alone. The breadth of the legislation itself does not include the over 300 separate reports, studies and rulemakings from over 13 separate federal agencies, the vast majority of which are required by July 15, 2011. There is rather a lot of law here, to put it mildly.

Even though the Act focuses mainly on financial institutions and the financial system, the effects of the Act will be felt throughout the economy at large and will be experienced by non-financial market participants. In this last respect, Dodd-Frank will have potentially significant consequences for energy companies and investors therein and related markets for energy goods and services. Financial institutions active in the energy sector no doubt have a lead on others in digesting the Act and assessing its impact on their activities. In our experience, non-financial institutions in the energy sector have some catching up to do. Because of this gap, and because it would exceed the space allowed to do otherwise, we are going to focus on the potential impact of Dodd-Frank on energy companies and energy markets generally.

Generally, the purpose of Dodd-Frank is to reduce systemic risk, increase transparency of the financial markets, and promote market integrity. Most likely, Dodd-Frank will affect energy companies in connection with their power marketing, hedging, and trading activities – in other words in connection with "swaps". The swap requirements of Dodd-Frank will range up and down a sliding scale depending on the firm's activities and the outcome of a federal rule-making process many months from completion. Those requirements may be glancing blows that increase the cost of hedging honest commercial risk (energy prices or interest on debt, for example) to full-on regulation and inspection by the Commodities Futures Trading Commission or the Securities and Exchange Commission. Title VII of the Dodd-Frank Act is called the Over-the-Counter Derivatives Reform and Transparency Act and covers "swaps"

and To establish a comprehensive regulatory framework to reduce risk, increase transparency, and promote market integrity within the financial system by, among other things (and in the Commodity Futures Trading Commission's own words): "(1) Providing for the registration and comprehensive regulation of swap dealers and major swap participants; (2) imposing clearing and trade execution requirements on standardized derivative products; (3) creating rigorous recordkeeping and real-time reporting regimes; and (4) enhancing the Commission's rulemaking and enforcement authorities with respect to all registered entities and intermediaries subject to the Commission's oversight."

The Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) have primary rulemaking authority over the swap provisions of Dodd-Frank and are required to make certain rulemakings jointly (either irony or wryly amusing to those who have experienced the occasionally open hostility of these two agencies to one another) and to generally consult with each other and with the US Treasury and others in their individual rulemakings. The jurisdictional boundaries between the CFTC and the SEC are based on whether a transaction is a "swap" or a "security-based swap". Security-based swaps are based on a security, loan or a "narrow" security index. The SEC has authority over "security-based swaps". The CFTC has authority over all other "swaps", including in all likelihood those most relevant to the energy industry. Congress expected the CFTC and the SEC to work together to produce harmonious rules, but already there has been some marked divergence.

As noted, Congress intended Dodd-Frank to become effective generally on July 15, 2011 (although some specific provisions have longer timelines for their respective effectiveness) and, where rulemaking by an agency is required, 60 days following that rulemaking. Hundreds of provisions in Dodd-Frank require rulemaking, and already several federal agencies are admittedly months, even up to a year, behind schedule. Even those federal agencies that are (or are close to being) on schedule have drawn sharp criticism for the fast pace (precluding consultation and careful deliberation regarding required rules) and lack of coordination (precluding or limiting effective participation by those affected or at risk of being affected) of their rulemaking activities. CFTC regulations on swaps were initially expected in early 2011. However, the CFTC in January 2011 announced it expected to conclude its rulemaking process in early 2012. It is an open secret that the complexity of the markets coming under regulation strains available agency personnel and existing regulatory concepts. The interrelatedness of the rules proposed and yet to be proposed is only a further complication.

Side-by-side markets for over-the-counter (OTC) and exchange-traded energy "swaps" have existed for years and, since the enactment of the Commodity Futures Modernization Act in 2000, without much regulation or oversight of the OTC energy derivatives markets. So exactly who and what will be regulated under Dodd-Frank? To some extent, and with only slight exaggeration, everyone involved with swaps and every swap transaction will be regulated. In a sign of how far we have to go, federal rulemaking has not yet finalized the definition of "swap", although the Dodd-Frank Act includes a broad definition (some say overly–broad) and requires a joint rulemaking by the CFTC and the SEC to further define "swap". In fact, no proposed rule to further define "swap" has yet been issued. Subject to the rulemaking process and a finite list of specific exclusions, under Dodd-Frank a swap will be any obligation based on a contingency, other than forward sales that are intended to be physically settled. (Indeed, the detailed list of activities caught up in the definition for "swap" includes the coverall "an agreement, contract, or transaction that is, or in the future becomes, commonly known to the trade as a swap."[2])

When all is said and done, all swaps (including all swaps on a firm's books as of Dodd-Frank's enactment) will have to be reported, either through an exchange/clearinghouse or self-reported to a "swap data repository" under an end-user exception to the mandatory clearing requirement or because the swap is not traded on an exchange/cleared by a

clearinghouse. The default mandatory requirement to clear all swaps through an exchange/clearinghouse mechanism would almost certainly subject firms irregularly hedging commercial risk to unaccustomed margining requirements, perhaps requiring daily margin calls, and to the resulting call on the firm's liquidity (margin must usually be cash or cash equivalents). Because of that implication, many of those providing comments to the CFTC's proposed rules have focused on the end-user exception to the clearing requirement.

If a firm can take advantage of the end-user exception, the swap does not need to be cleared as described. It must still be reported to the CFTC along with specified information about the end-user. The end-user exception imposes a number of requirements, including:

1) The trade must hedge or mitigate commercial risk;

2) One party to the trade (in our hypothetical, the energy firm) cannot be a financial entity (generally, an institution subject to any one of a number of federal banking, broker/dealer, and investment company regulations);

3) In connection with reporting the trade in question, the party that is not a financial entity must report to the CFTC how it meets its financial obligations for trades that are not cleared (Recall that the end-user exception merely relieves the obligation to clear the trade through a clearinghouse);

4) SEC filers claiming the end-user exception must have board approval for the non-cleared trade.

Each trade for which the end-user exception is elected must be reported. The report must include information about the firm and, as we say, how the firm meets its financial obligations for trades that are not cleared. The information required in this regard includes whether the firm has credit support, has pledged or segregated assets, intends to rely solely on available resources, has a guaranty from some other entity or has other means of satisfying its financial obligations in connection with un-cleared trades.

Our strong hunch is that most firms will shrink from the burden and cost of these reporting requirements and, other than in connection with the most valuable bespoke trades for which no clearing mechanism exists, simply take their lumps and pay the incremental cost of executing the trade through a clearinghouse and bear the cost and hassle of margining.

Under Dodd-Frank, forward contracts that are intended to be physically settled are excluded from "swaps". Accordingly, a traditional power purchase agreement that provides for physical settlement should not need to be cleared or reported. Most likely, typical "book-out" (agreeing to a financial settlement instead of required physical settlement) will not cause a power purchase agreement to become a "swap" even though the contract is not in fact physically settled. It is an open question, and a serious one, whether power purchase agreements for delivery within ISO regions that act as brokers for all trades, such as NY ISO, will qualify as "intended to be physically settled." It is also not clear yet whether REC contracts qualify as swaps (are they "emission" swaps or something else?). Industry groups have asked the relevant government agencies to exclude them, but as with most of Dodd-Frank's swap regulations, the government has yet to produce a final rule Similarly, emission allowance swaps (that are specifically identified as "swaps" in Dodd-Frank) raise the "physically-settled" question (since there may be no "physical" to actually settle), although various industry groups have urged the CFTC to include them in the exclusion. Finally, there are a number of potential "swaps," – e.g., financial transmission rights, auction revenue rights and others that have been specifically created or authorized by the US Federal Energy Regulatory Commission (FERC) as part its opening of energy markets to wholesale competition, where CFTC regulatory oversight was not expected, would be intrusive on existing and established FERC authority, and would risk substantial burden without obvious economic or other benefit. Notably, a required memorandum[3] to Congress from both the CFTC and FERC regarding the demarcation of their respective regulatory authorities is now several months' overdue.

Significant players in the energy swap markets are likely to be the most highly regulated – including reporting, business conduct and capital requirements. These entities will themselves be regulated, as opposed to the regulation of any particular energy trade. These affected players will be "swap dealers," "major swap participants," clearinghouses, exchanges and data repositories. Of course, regulation of clearinghouses and exchanges predates Dodd-Frank, but these will now be subject to increased oversight and regulation. So-called "swap execution facilities" and "swap data repositories" are new statutory creatures, created by Dodd-Frank, and are generally intended to facilitate market transparency. Swap dealers (SDs) will be generally defined by their activities. SDs are market makers, accommodate trades, and generally stand on both sides of trades. Major swap participants (MSPs) will be defined by a proposed arithmetic formula. The MSP rules are designed to catch big players like AIG, firms holding billion dollar and more trades and substantial swap exposures. As with the rest of Dodd-Frank in this area, the CFTC and SEC are still working on the rules that will provide final rules and guidelines for these entities.

Despite these significant unknowns, we feel confident in saying that most energy companies should not be regulated as SDs or MSPs and will almost certainly not find themselves to be unexpected clearinghouses, exchanges, swap execution facilities or swap data repositories. On the one hand, it should be quite clear to an energy firm that its hedging and trading activities propel it into the stratosphere of players caught up by the SD or MSP rules. Any firm whose trading activities are at those MSP-type levels should already be aware of it and will have to monitor the Dodd-Frank rulemaking process. The rules regarding SD status will be slightly more ambiguous. Firms will have to monitor their respective personnel and the conduct and activities thereof more closely to ensure they do not unintentionally cross the line once established by final rule. ◆

Endnotes

1 The Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. 111-203).

2 Dodd-Frank Act § 721(a)(21).

3 Dodd-Frank Act §720(a)(1).

UK—Updated Prospectus Content Recommendations for Mineral Companies

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The European Securities and Markets Authority (ESMA) successor to the Committee of European Securities Regulators (CESR) has published an update of the CESR recommendations for the consistent implementation of the Prospectus Directive, with revised recommendations as to the content requirements of prospectuses issued by mineral companies. The CESR recommendations contain various recommendations as to the content of prospectuses, and are taken into account by the UK Listing Authority (UKLA) in deciding whether a prospectus should be approved.

Mineral companies are distinct from other companies in that a key factor in the assessment of their value is their reserves and resources. A key challenge for regulators is to ensure appropriate levels of transparency and assurance over the reserves and resources figures reported to the market. The CESR recommendations set out a framework for additional disclosure of reserves and resources information. Following concerns that this framework lacked clarity compared to regulatory standards in other markets, in April 2010 the CESR launched a consultation on a new framework for disclosure.

ESMA became CESR's successor at the start of 2011. On March 23, 2011, ESMA published a feedback statement on the April 2010 consultation, together with ESMA's update of the CESR recommendations. The ESMA update largely follows the amendments proposed in the April 2010 consultation. This article considers some of the key provisions of the updated recommendations.

Which Companies Are Subject to the Updated Recommendations?

"Mineral companies" now means companies with material mineral projects, not just those whose principal activity is the extraction of mineral resources. The materiality of projects will be assessed in regard to all the company's mineral projects relative to the issuer and its group as a whole. Companies performing only exploration are no longer exempt from the recommendations. However, mineral companies that are only issuing wholesale debt will be exempt from the recommendations (historically, the recommendations applied to all prospectuses issued by a mineral company).

Competent Persons Report

A competent persons report (CPR) will be required for all initial public offering prospectuses regardless of how long the issuer has been a mineral company, and not just where the issuer has been a mineral company for less than three years. A CPR may also be required for

further issues, but not where the issuer has previously published a CPR and has continued to update the market regarding its resources, reserves, results and prospects in accordance with one of the recognised reporting standards. In its April 2010 consultation, CESR noted that market practice expects a CPR at float but not generally after float and the updated recommendations are consistent with this practice.

The updated recommendations include recommended content for the CPR. The recommended content varies depending on whether the CPR relates to a company with oil and gas projects or a company with mining projects.

The proposal to include a CPR in a prospectus where there have been significant changes (either through acquisition or organic development) has not been adopted—instead, an overview of the new assets will be required. However, a mineral experts report will continue to be necessary under the UKLA Listing Rules on a Class 1 acquisition or disposal of mineral resources.

Basic Disclosure Requirements

The updated recommendations continue to set out basic disclosure requirements for all prospectuses.

Reporting and Valuation Standards

A new list of acceptable internationally recognised reporting and valuation standards has been drawn up. The oil and gas reporting codes are derived from the Society of Petroleum Engineers' Petroleum Resources Management System. The mining reporting codes are aligned with the Committee for Mineral Reserves International Reporting Standards (and do not include US SEC Industry Guide 7 on mining, or the Russian or Chinese standards).

Cash Flow Projections

Historically, mineral companies without a three-year trading history were also required to include a two-year cash flow projection validated by accountants. In its April 2010 consultation, CESR proposed to abolish this requirement and to replace it with a new requirement to expand the use of proceeds section of the prospectus where new funds are being raised to finance exploration or development. While the requirement for a cash flow projection has been abolished as proposed, the new requirement in relation to use of proceeds has not been implemented.

Conflict with Third Country Securities Laws

The updated recommendations include a provision allowing an issuer to omit an item required by those updated recommendations where third country securities laws prohibit disclosure of that item.

Comment

This is a sensible move back to a more prescriptive regime, along the lines of the old Chapter 19 Listing Rule requirements. While these were replaced in 2005, many companies, advisers and even the UKLA still take note of them. ◆

Natural Gas In Brazil

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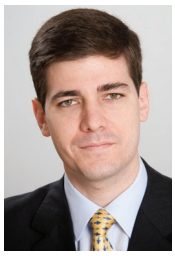

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Since 1997, the government of Brazil has been using a general hydrocarbons law to regulate all upstream, mid-stream and downstream activities, relating either to oil or natural gas. This sometimes resulted in situations that were difficult to address or projects that were impossible to implement due to the lack of legal authorization. After many years of anticipation, on March 4, 2009, the government finally published the Natural Gas Law (Law No. 11,909) to regulate the natural gas industry in Brazil.

Even though the Natural Gas Law was published early in 2009, the necessary decree to implement and allow the enforceability of the law was not issued by the president of Brazil until December 2, 2010. The Decree (No. 7,382), among other stipulations, provides: (i) the rules for access to the gas transportation activities upon the grant of a concession regime or issuance of authorization; (ii) the creation of the Ten-Year Plan for Expansion of Gas Pipelines (Pemat), to be issued by the Ministry of Mines and Energy; (iii) the rules for third-party access to gas pipelines; (iv) the natural gas swap and (v) the rules applicable to the exclusivity period of gas pipelines, which shall be at most 10 years.

Although the law and the decree are relatively recent, and it is not possible to anticipate how certain provisions will work in the "real world," this move by the government of Brazil was seen as very positive by the private sector, as it creates some competition for the construction and operation of pipelines, which was still under monopoly.

It is important to mention that the Decree enhances the enforceability of the Natural Gas Law by structuring the new regulatory framework. However, there are certain outstanding issues that shall be regulated later by the Brazilian Ministry of Mines and Energy and the National Petroleum Agency through the issuance of additional rules for the effective implementation of new regulations for the natural gas industry.

Even with the current uncertainties and regulatory gap, it is possible to say that the Natural Gas Law and the Decree create incentives for private investment in the Brazilian Natural Gas sector. This is especially in relation to the construction and operation of gas pipelines, gas storage and liquefied natural gas (LNG) facilities, once it provides for the (i) allocation of government funds to invest in some projects, (ii) creation of mechanisms to regulate competition and to facilitate financing and (iii) establishment of stronger competition rules regarding open access to existing pipelines.

Generally speaking, the Natural Gas Law represents an important development in the Brazilian oil and gas sector, as it allows private companies to submit proposals to the Brazilian Ministry of Mines and Energy to develop a new pipeline project or to enhance the capacity of any existing pipeline. Such proposals may be authorized by the Ministry directly or may require a public tender conducted by the Brazilian National Petroleum Agency, depending on the evaluation of the Ministry of Mines and Energy.

In addition to the submission of proposals by private companies, the Natural Gas Law also authorizes the Ministry of Mines and Energy to propose new pipeline projects or capacity increases to existing pipelines through public tenders, ensuring certain guidance power over the market.

Although the Natural Gas Law allows such initiatives by private companies, the law also directs the National Petroleum Agency to organize a public call for natural gas carriers to make capacity commitments before any new pipeline project or capacity increase is approved, as part of a commitment to ensure a reasonable demand for every existing pipeline.

Additionally, the law authorizes the Ministry of Mines and Energy to grant exclusive rights to owners of new pipeline projects, during which open access rules will not apply. Existing pipelines are entitled to a 10-year exclusivity period, beginning on the commercial operation date, after which open access is made available to third parties. LNG and processing facilities are not subject to open access obligations.

Finally, the Natural Gas Law allows the Ministry of Mines and Energy to use Public-Private Partnerships to encourage and promote the economic feasibility of any new pipeline project or capacity increase. It also allows self-production of natural gas, including the construction of pipelines by self-producers, but requires that self-producers assign the operation and maintenance of their pipelines to the local natural gas distributor. This requirement might be considered positive by companies already doing or interested in doing business in Brazil.

Even with the issuance of the Decree, there are several implementation details open for development through future rules and actions by the Ministry of Mines and Energy and the National Petroleum Agency. However the Natural Gas Law establishes a number of very important principles and would appear to bring more assurance to investors and more reliability to the natural gas markets. ◆

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