MAYER • BROWN

Summer | 2012

Global Energy Industry
REVIEW

1 The New AIPN 2012 Model Form Joint Operating Agreement—What's New?

4 Production and Wholesale of Conventional Electricity in Germany Exempted from EU Public Procurement Rules

7 Deepwater Oil Production in Vietnam

11 EU Focus—Where do We Stand on the Reshaping of the Energy Taxation Directive?

14 Fostering Wind Energy Development in the Great Lakes

16 Mayer Brown Global Energy News

Our Global Energy Practice

Mayer Brown has advised major participants in the energy sector across the entire spectrum of their operations and has acted as counsel of choice with regard to significant transactions and litigation matters. Our Energy practice includes attorneys from the key disciplines of finance, corporate, securities, tax, environment, trade and energy regulation and dispute resolution, as well as US and EU regulatory capabilities in Washington, DC and Brussels.

Our attorneys have earned an enviable reputation in the energy industry. Our worldwide client base includes companies representing the full spectrum of the energy industry, and those that finance or invest in them. We have advised clients in the following energy sectors:

OIL AND GAS	POWER	RENEWABLE ENERGY
Exploration & Production	Electric	Wind
Midstream	Natural gas	Solar
Downstream	Transmission	Biomass
Pipeline	Coal	Hydro
Liquefied Natural Gas (LNG)	Nuclear	Geothermal
Petrochemicals		Waste-to-Energy

We draw together talent from our offices around the world, including the principal energy and energy finance centers of London, New York, Hong Kong and Houston. These market centers have a tradition of hosting, servicing or financing energy firms and we have a substantial presence in each of them.

Editors' Note

Marc Folladori
North America Energy Leader
+1 713 238 2696
mfolladori@mayerbrown.com

Xiangyang Ge
Asia Energy Leader
+86-10 6599 9327
xiangyang.ge@
mayerbrownjsm.com

Robert Hamill
UK/Europe Energy Leader
+44 20 3130 3558
rhamill@mayerbrown.com

Alexandre Chequer
Latin America Energy Leader
Tauil & Chequer Advogados
+55 21 2127 4212
achequer@mayerbrown.com

In this edition of Mayer Brown's *Global Energy Industry Review*, we begin by highlighting key revisions of the Association of International Petroleum Negotiators' 2012 Joint Operating Agreement (JOA). It is expected that this new JOA will take over as the new international industry standard, and our article examines how some of the changes reflect the latest commercial realities of the upstream oil and gas sector, particularly in light of events such as the Deepwater Horizon tragedy and the implementation of the UK Bribery Act 2010.

We then turn to Germany and share details of the European Commission's recent decision to generally exempt from the EU procurement rules all public companies active in the production and wholesale of conventional electricity in Germany.

More than a year ago, the European Commission published its Proposal for a Council Directive, amending Directive 2003/96/EC and restructuring the European Community framework for the taxation of energy products and electricity (the Energy Taxation Directive). We discuss what the proposal is seeking to achieve and provide some insights on where the process actually stands.

Moving to the continent of Asia, we take an in-depth look at the declining oil production in Vietnam and how the increasing needs for energy are requiring this nation to strengthen the exploration and development of its deepwater resources.

Looking to the United States, we highlight efforts to increase offshore wind energy development off the Atlantic Coast by the current US administration and five of the eight Great Lakes states, which have signed a memorandum of understanding intended to streamline the efficient and responsible development of offshore wind energy resources.

Finally, we close the summer issue of the Review by sharing significant Mayer Brown Global Energy News.

This edition of *Global Energy Industry Review* showcases current energy-related trends around the world. We regularly publish legal updates on timely industry issues. Please visit our Energy News and Publications page to view a complete list of our energy updates.

If you have questions or comments on any of the articles in this edition, please contact us. ◆

The New AIPN 2012 Model Form Joint Operating Agreement — What's New?

Sam Webster

Sam Webster
London
T +44 20 3130 3239
swebster@mayerbrown.com

After four years of research, consultation and drafting, the Association of International Petroleum Negotiators (AIPN) has published a new version of its model Joint Operating Agreement (2012 JOA), replacing the previous version (2002 JOA).

The 2012 JOA is expected to take over as the new international industry standard, and in this article we look at some of the key revisions made to the model form to reflect the latest commercial realities of the upstream oil and gas sector, particularly in light of events such as the Deepwater Horizon tragedy and the implementation of the UK Bribery Act 2010.

Operator's Liability

The extent of an operator's liability, both to third parties and to its non-operator partners, has long been a topic of debate, and has been brought into sharp focus recently by the legal fallout from the Deepwater Horizon explosion and oil spill. To what extent should an operator be liable for losses and liabilities—including third-party claims, environmental liabilities and clean-up costs—arising from joint operations?

The commercial starting point is generally that an operator should neither profit nor suffer loss from acting as operator, and the 2012 JOA maintains the default position from the 2002 JOA that an operator's liability shall be limited to the amount of its participating interest share in the operations. This follows the commercial reality that no party would agree to act as operator without making a profit unless it could significantly reduce, or eliminate entirely, its exposure in performing that role.

The one exception to the limitation of liability, which is an optional provision in the model form but which is normally fiercely argued for by non-operators, is in the case of "gross negligence/willful misconduct" by the "senior supervisory personnel" of the operator. The 2012 JOA adds some optional wording to help define "senior supervisory personnel," but the substance of the carve-out is unchanged and it remains a very narrow exception. Even if the operator does agree to its inclusion, the carve-out does not apply to consequential or environmental losses, so any environmental clean-up costs, for instance, will remain the joint responsibility of all parties.

Decommissioning

Given the recent focus on decommissioning costs in mature oil and gas fields, particularly in the North Sea, it is no surprise to see significantly more detailed provisions in the 2012 JOA regarding decommissioning. The

key objective of the new provisions is to ensure that one co-venturer does not bear a disproportionately large share of such costs.

The 2012 JOA requires decommissioning to be carried out "in accordance with good oil field practice" and all legal obligations, and the operator must now deliver to the operating committee an estimated decommissioning work program and budget at the outset of any development plan.

In terms of making adequate financial provision for future decommissioning costs, the 2002 JOA required the parties to negotiate a suitable security agreement, whereas the 2012 JOA contains an optional set of provisions, in Exhibit E, to deal with this at the outset. Exhibit E contemplates the creation of a trust fund, to which the parties are required to contribute whenever the operator issues a trust fund cash call. The parties can, as an alternative to payment, provide security.

Bribery and Corruption

This is another topic that has come to the fore recently, following the implementation of the UK Bribery Act (the Act) and the continued enforcement of the Foreign Corrupt Practices Act in the United States. The 2012 JOA bolsters the compliance protections already in place from the 2002 version.

New optional wording allows the parties to set the standard of "anti-bribery laws and obligations" to a level that would ensure compliance with the Act. This is to be recommended given the Act's ability to impose liability on one party for acts committed by that party's associates or co-venturers, which could include JOA partners. The most likely trigger event is the payment of a bribe to a public official.

The key protections include warranties as to past compliance, covenants as to future compliance and certain specific obligations on the operator. These include implementing suitable anti-bribery policies and procedures and ensuring that similar protections are included in all contracts with suppliers and other third parties.

The "teeth" of the new anti-bribery provisions come in the form of wide indemnities to cover any losses suffered by the non-breaching parties, and an optional provision entitling the non-operators to remove the operator for violating the anti-bribery laws and obligations.

Default

JOA parties often devote a significant proportion of their negotiating time to the consequences of a default, specifically a failure by one party to satisfy a cash call. The drafting committee for the 2012 JOA paid particular attention to this area.

The most significant changes in the 2012 JOA concern the remedies available in the event of a default. The new model form preserves the existing remedies from the 2002 JOA—namely forfeiture, buy-out and enforcement of security—but also introduces a new remedy, the so-called "withering option." Rather than forcing the defaulting party to forfeit its entire participating interest (which in some jurisdictions may be considered unenforceable), the withering option gives the non-defaulting parties the right, during an approved development plan, to acquire a part of the participating interest in the actual exploitation area to which the default relates. This "withering interest" is calculated by reference to a detailed contractual formula.

While the new drafting is complex and will likely require the parties to commit greater resources to the JOA negotiations, the withering option does bear certain advantages. As a remedy it is more proportionate than a complete forfeiture because it is measured against the extent of the default, and therefore avoids the enforceability concerns with "disproportionate" remedies. The new remedy also provides continuity by enabling the defaulting party to remain in the rest of the project.

Work Programs and Budgets

A further theme of the 2012 JOA is that the parties will in greater detail agree to the content, sharing and approval of all information relating to joint operations. This comes in response to concerns about operators not providing adequate and timely information to non-operators.

This is particularly the case for work programs and budgets, with new provisions prescribing the

content to which operators must adhere and setting out how and when operating committee approval must be given to ensure that the operator is in a position to submit the work program and budget to the government when required to do so under the relevant production-sharing contract.

There is also the option for the parties to set different approval thresholds depending on whether the contract is in the exploration, appraisal, development or production phase, giving the JOA parties greater flexibility in the way that approvals are given. ◆

Production and Wholesale of Conventional Electricity in Germany Exempted from EU Public Procurement Rules

Robert Klotz

Robert Klotz
Brussels
+32 2 551 5975
rklotz@mayerbrown.com

On 24 April 2012, the European Commission adopted a formal decision generally exempting from the EU procurement rules all public companies active in the production and wholesale of conventional electricity in Germany. The exemption covers all contracts for the purchase, construction, operation and maintenance of conventional power plants—e.g., gas and coal-fired ones—as well as related support activities such as combined heat and power plants (CHP).

This decision is based on a formal request that was filed by Robert Klotz with the European Commission on behalf of BDEW (German Association of Energy and Water Industries), representing approximately 1,800 companies active in the natural gas, electricity and district heat, water and wastewater sectors in Germany.

Following the liberalization of the energy sector, many private companies are now active in the production and wholesale of electricity in Germany, and are not subject to the public procurement rules. By exempting their public competitors from these rules, the decision now establishes more homogenous conditions for competition in this key market. This is the first time that the Commission has granted such an exemption for a German market, after similar decisions had previously been adopted for Austria, England, Wales, Finland and Sweden, among others.

Public Procurement in Regulated Sectors

Directive 2004/17/EC aims to coordinate the public procurement procedures of entities operating in the water, energy, transport and postal services sectors; it contains specific rules for the procurement of products or services by public undertakings. Contracts falling within the scope of the directive must therefore be concluded subject to special conditions regarding transparent and non-discriminatory award criteria, in order to ensure open competition.

It is possible, however, for affected EU Member States and companies, or their associations, to request an exemption from the provisions of the directive. Pursuant to Article 30 of the directive, such exemptions will be granted with respect to a given market, subject to two conditions: (i) there must be unrestricted access to this market and (ii) the market must be directly exposed to competition. Access is deemed to be unrestricted if the Member State has implemented and applies the relevant EU legislation liberalizing the market in question. Key factors for the assessment of direct exposure to competition include market shares of the main players (concentration ratio) as well as market liquidity, size of imports and

exports, price competition and the extent of customer switches.

These criteria are not strictly identical to those commonly used for the competitive assessment of markets under the EU antitrust and merger control rules. This is due to the specific objectives of the directive. Exemptions from the public procurement rules will be granted if the level of competition on the relevant market ensures that even in the absence of the public procurement rules contracts will be awarded in a transparent and non-discriminatory manner, in the interest of reaching the most economically advantageous solution.

The Exemption Decision

In October 2011, BDEW formally requested an exemption on behalf of its member companies for the purchase, construction, operation and maintenance of all their electricity generation plants, and relevant support activities, as well as for the wholesale of electricity. This request included both conventional and renewable power plants.

Following a mandatory opinion provided by the German Federal Cartel Office, the Commission defined a narrower relevant product market for the generation and wholesale of electricity produced only from conventional sources, thus excluding generation and wholesale of electricity from renewable sources. In Germany, the latter are subject to the specific regime of the Act on Renewable Energy (EEG), based on guaranteed minimum feed-in tariffs. While such EEG electricity exercises some competitive pressure on energy generated from conventional sources, this was not considered to be reciprocal, due to the feed-in priority for electricity from renewable sources. This is seen by the authorities as a form of subsidy rendering such electricity independent from the actual demand.

The Commission then decided that the above-mentioned exemption criteria of Article 30 Directive 2004/17/EC were fulfilled with respect to the German market for generation and wholesale of electricity produced from conventional sources. Access to such markets is deemed unrestricted, because Germany has implemented Directive 2009/72/EC as well as the previous Directives 96/92/EC and 2003/54/EC, which provide for the liberalization of, and open third-party access to, the German electricity markets.

Although characterized by the presence of four big companies, and with the the cumulative market share of the first three producers still being as high as 70 percent in 2010, the Commission found sufficient indications that the German market for the production and wholesale of electricity from conventional sources was directly exposed to competition. This is particular due to the fact that the first two producers (E.ON and RWE) are private undertakings, and therefore not subject to the procurement rules. Thus, these companies were able to exercise significant competitive pressure on the (mostly smaller) public market players. These findings were backed up by a study the Commission had published in June 2011 on the progress in creating an internal energy market, where it was found that the concentration of the German electricity market had decreased in recent years, so that the market could be classified as only moderately concentrated.

The Commission further found that competitive pressure on the German conventional electricity market is exercised by importers of electricity. This is due to the fact that Germany switched from being a net exporter to a net importer of electricity after several nuclear plants were closed in 2011. Other factors for the finding of competitive exposure of the relevant market were the increasing number of customer switches, the high degree of liquidity on the electricity wholesale market and the characteristics of the German balancing market with market-based pricing and price differences between positive and negative balancing power. These are interesting conclusions also for the big private operators E.ON and RWE, which do not otherwise directly benefit from the exemption decision.

Consequences and Outlook

As a result of the decision, which was already published in the Official Journal of the EU (L 114 of 26 April 2012, page 21 et seq.) and entered into force immediately, the provisions of Directive 2004/17/EC no longer apply to any contracts awarded by public

companies for the production and wholesale of electricity produced from conventional sources in Germany. For those companies, all of which are members of BDEW, this leads to significant benefits through reduced cost, shorter procedures and more legal certainty for their power generation projects.

The exemption decision, however, does not cover any contracts related to the production and wholesale of renewable electricity subject to the special EEG regime which is currently not deemed to be directly exposed to competition. This includes electricity-based on sources such as hydro (wave, tidal, salt gradient and flow energy), wind, solar, geothermal, biomass, landfill gas and sewage gas, as well as biodegradable parts of waste incineration in Germany.

There is, however a strong trend toward more direct marketing of such electricity volumes with an increasing number of generators not opting for the guaranteed feed-in tariffs under the EEG. As soon as this trends leads to a sufficient degree of substitution between conventional and renewable sources, it may justify a separate request to the Commission also seeking the exemption of such activities from the EU public procurement rules. In the meantime, the same mechanism may of course also be used for other markets in network industries of other EU Member States. ◆

Deepwater Oil Production in Vietnam

Kevin Hawkins
Orsolya Szotyory-Grove

Kevin B. Hawkins
Ho Chi Minh City
+84 83 822 8860
kevin.hawkins@
mayerbrownjsm.com

Orsolya Szotyory-Grove
Ho Chi Minh City
+84 83 822 8860
orsolya.szotyory-grove@
mayerbrownjsm.com

Vietnam's declining oil production and growing energy needs will require the nation to intensify exploration and development of its deepwater resources. Continued reform of regulations governing oil exploration is necessary to attract foreign investors, who bring with them the technology and expertise necessary to undertake complex deepwater drilling projects.

Waning Conventional Production in a Time of Growing Energy Demand

Forecasts indicate that Vietnam's oil production will decline to only 313,000 barrels per day (bpd) by 2020.[1] Oil consumption in Vietnam, however, is set to increase by 69 percent between 2011 and 2020, with annual growth of 5 percent to 7 percent.[2] By 2020, Vietnam will consume about 554,000 bpd.[3]

Current offshore exploration activities on the continental shelf are largely limited to depths of less than 100m (about 328 feet), and cover only about 25 percent to 30 percent of the available surface.[4] The remaining 70 percent to 75 percent of the continental shelf, with water depths of 100m or more, is largely unexploited and open for new bidding.[5]

Breaking Technological Boundaries Will Require Revision of Vietnam's Regulatory Environment

As the shallow water reserves are depleted, attention has shifted to the unexplored deepwater fields, which evidence suggests have larger reserves and potential productivity. Among the nearly 500 new oil fields discovered in 2009, the 340 onshore fields account for only 35 percent of total discovered reserves, the 80 shallow fields account for 20 percent, while the remaining 60 deepwater fields are the source of 45 percent of total discovered reserves.[6] Vietnam now ranks third in terms of proven oil reserves in the Asia-Pacific region, with 4.4 billion barrels.[7] Accessing those reserves in deepwater areas will require overcoming technical and regulatory obstacles.

ACCESS TO DEEPWATER DRILLING TECHNOLOGY

Deepwater exploration requires the use of complex, cutting-edge technology. Usually, deepwater drilling requires deployment of specialized drilling rigs, such as semi-submersibles, drill ships or tension leg platforms. The equipment must be able to withstand extreme pressure in the borehole, and support the weight of drilling far into the surface.

In addition to equipment, data collection is essential to efficient deepwater drilling. Seismic and well data must be collected, processed and interpreted. The data collection technology must also take geographical anomalies into account. For example, salt layers in the seabed may impact seismic imaging technology and make it difficult to visualize the physical structures that contain oil. The preferred technology for obtaining accurate images, particularly in a physically challenging environment, relies on newer, three-dimensional imaging.

Moreover, drilling techniques develop rapidly, and an approach that was optimal several years ago may no longer be the most effective or the safest method. For example, conventional deepwater drilling uses a single drilling fluid in the borehole. More advanced methods use two different kinds of drilling fluid, one designed to be used above the seabed, and the other below. This allows drilling to be calibrated to the pressures encountered at different depths, and enables the operator to respond appropriately to pressure changes.

Other necessary technological considerations are safety measures and procedures put in place to protect the environment.

The kinds of equipment required are not readily available in Vietnam. Vietnam is currently only able to build fixed platforms, which can reach depths of only 130m. Moreover, the cost of constructing and deploying advanced rigs and floating platforms is another serious obstacle. There are also insufficient numbers of trained and qualified personnel to operate the equipment and collect and interpret data.

ENCOURAGING FOREIGN INVESTMENT THROUGH REGULATORY REFORM

Securing the necessary technology to reach its deepwater reserves requires enabling participation of foreign investors in Vietnam's oil exploration and production projects.

The National Strategy for Energy Development through 2020 sets out the basic framework for the development of Vietnam's energy policies.[8] The National Strategy focuses on objectives that will accelerate oil and gas exploration to meet the nation's energy needs, including accurate evaluation of petroleum reserves, and expansion of exploration and exploitation of petroleum.[9] In addition, the National Strategy sets out specific development plans for the petroleum industry: "to encourage and speed up petroleum survey and exploration activities; to build a transparent and effective system for supervising and assigning contracts on exploration lots; to periodically revise financial terms so as to make petroleum exploration and development investment activities in Vietnam competitive with those in other countries."[10]

Vietnam has already begun to implement these objectives. New regulations enacted in 2009 and 2010 clarified the investment and bidding regulations for petroleum exploration. The basic bidding guidelines are contained in Decree 34/2001/ND-CP (6 July 2001) (Decree 34), which was amended by Decree 115/2009/ND-CP (24 December 2009) (Decree 115). Decree 34 sets out the steps for the process of soliciting, preparing and accepting bidding dossiers. The Decree 115 amendments provide further detail on bidding norms, bidding plans and bid evaluation teams. In addition, the amendments require Vietnam Oil and Gas Group (PetroVietnam) to work out and update an annual master plan on bidding for petroleum blocks.[11]

Recent legislation also enhances contractual flexibility by permitting investors to extend exploration agreements past project deadlines. Decree 48/2000/ND-CP (12 September 2000) (Decree 48) provides implementing guidance for the Law on Petroleum, and regulates oil exploration and production activities. Decree 48 was also amended by Decree 115. While the original text of Decree 48 permitted extensions on a contractual period for exploration, the amendments expand the circumstances in which investors may seek an extension. In addition to extending the period for exploration, an investor may now also extend the duration of the petroleum contract itself for an additional five years.[12] Moreover, Article 25a provides for a special extension in cases of national security upon approval of the Prime Minister. Although the amendments do not outline the specific kinds of national security concerns that may be used to invoke a special extension, given the emphasis of the National Strategy on securing domestic energy

needs, there may be some flexibility in seeking an extension on this basis.

These changes reflect a policy-level emphasis on facilitating the development of Vietnam's oil reserves. The cost and difficulty of exploration in deepwater areas suggest that foreign investors may wish to seek enhanced contractual rights. The current changes by themselves may not be sufficient in the long term to secure the level of foreign investment required to move into deepwater production. They do, however, demonstrate Vietnam's commitment to revise its legislative program in that context. Continued reform will be essential to growing foreign participation in deepwater oil exploration and production.

Other Challenges

Vietnam's oil interests extend into the South China Sea, where territorial disputes with other Southeast Asian countries, including China, pose a potential impediment to the development of deepwater exploration.[13] Vietnam has reached out to other nations in a joint effort to explore and produce oil in the contested region. For example, in October 2011, ONGC Videsh, India's national oil company, signed an agreement to launch a joint exploration program in the South China Sea with PetroVietnam.[14]

Current Deepwater Projects

Vietnam has increased the frequency of international licensing rounds. The second bidding round was launched in 2007, and included several blocks in difficult exploration areas in the Song Hong and Phu Khanh Basins.[15] A limited bidding round was held in 2008 for seven additional blocks. Four production-sharing contracts (PSCs) were signed after the 2008 bidding round, and an additional 19 were signed between 2009 and 2010.[16] The most recent international bidding round began in late 2011, and includes blocks from Nam Con Son, Phu Quoc and Malay Tho Chu Basins.[17]

Phu Khanh Basin: These blocks are as much as 400m deep. India's ONGC Videsh Ltd. was awarded a PSC in 2006 to explore these blocks of Phu Khanh Basin, but surrendered Block 127 to PetroVietnam in early 2011 after its exploration efforts did not yield any results. Recent news reports have suggested Videsh may give up its rights in block 128 as well.[18]

Song Hong Basin: In 2007, Vietnam opened for bidding seven deepwater blocks in Song Hong Basin where, according to PetroVietnam reports, the potential hydrocarbon reserves are more than 5 billion barrels of oil equivalent (boe).[19] The oil and gas community regards this bidding round as part of Vietnam's intensive effort to attract foreign investment in deepwater exploration and production.

Nam Con Son Basin: In April 2012, Gazprom announced that it had reached an agreement with PetroVietnam to jointly produce natural gas from blocks 5.2 and 5.3 located in Nam Con Son Basin, from which BP had withdrawn in 2009. These two blocks, with depths of up to 150m (about 492 feet), are estimated to have natural gas reserves of up to 55.6 billion m3.[20]

Planning for the Future

The era of easy oil extracted from readily accessible shallow water is almost over and deepwater fields represent a new opportunity for oil production. Vietnam has recognized the necessity of leveraging foreign capital and high technology to satisfy its growing energy needs to access oil at deepwater levels. Its ability to do so depends on its willingness to provide a legal environment amenable to foreign investment. ◆

Endnotes

1 Business Monitor International Ltd., "Vietnam Oil & Gas Report Q4 2011."

2 *Ibid.*

3 *Ibid.*

4 Alex Chakhmakhchev and Peter Rushworth, "Global overview of offshore oil & gas operations for 2005-2009," http://www.offshore-mag.com/articles/print/volume-70/issue-50/international-e_p/global-overview-of.html, accessed 15 May 2012.

5 *See* Oil & Gas Journal (OGJ), reprinted in: Energy Information Administration, "Vietnam—Country Analysis Briefs, May 2012."

6 Prime Minister's Decision No. 1855/QD-TTg (27 December 2007) (the "National Strategy").

7 National Strategy, art. 2(b).

8 National Strategy, art. 3(c).

9 Decree 34, art. 8(a).

10 Article 17 of the amended Petroleum Law, 10/2008/QH12, stipulates that a petroleum contract may be extended for up to five years.

11 Tom Wright, "Vietnam, India Stand Firm on China Row" (2011), *The Wall Street Journal*.

12 Rakesh Sharma, "ONGC Videsh Signs Pact With PetroVietnam" (2011), *The Wall Street Journal*.

13 Energy Information Administration, "Vietnam—Country Analysis Briefs, May 2012."

14 *Ibid.*

15 *Ibid.*

16 Rakesh Sharma, "ONGC Videsh May Surrender Vietnam Block" (2012), *The Wall Street Journal*.

17 Jeff Moore, "Oil and Gas in the Capitals" (2008), *World Oil*, Vol. 299 No.1.

18 "Russian Gazprom teams up with Petro Vietnam in oil and gas exploitation" (2012), Vietnam Investment Review, http://www.vir.com.vn/news/business/russian-gazprom-teams-up-with-petro-vietnam-in-oil-and-gas-exploitation.html, accessed 15 May 2012.

EU Focus — Where do We Stand on the Reshaping of the Energy Taxation Directive?

The very substance of the ambitious is merely the shadow of a dream ~*William Shakespeare*

Astrid Pieron
Charles-Albert Helleputte

Astrid Pieron
Brussels
+32 2 551 5968
apieron@mayerbrown.com

Charles-Albert Helleputte
Brussels
+32 2 551 5982
chelleputte@mayerbrown.com

A year has passed since the publication, in April 2011, by the European Commission (EC) of its Proposal for a Council Directive amending Directive 2003/96/EC (the Proposal), restructuring the European Community framework for the taxation of energy products and electricity (the Energy Taxation Directive). The purpose of this short contribution is to briefly discuss what the Proposal is seeking to achieve and provide some insights on where the process actually stands.

The core principle behind this reshaping is a changing paradigm that introduces an explicit distinction between two types of energy taxation that are either (i) specifically linked to CO_2 emissions attributable to the consumption of products (CO_2-Related Taxation) or (ii) based on the energy content of products (General Energy Consumption Taxation).

CO_2-Related Taxation will not overlap with the European Trading Scheme (ETS), as the Proposal generally provides for taxation unless the ETS applies.

Background

The Energy Taxation Directive was adopted in 2003. Since then, the underlying policy framework changed radically, as concrete and ambitious policy objectives have been defined for the period until 2020 by the EU climate and energy package. The European Council instructed the EC to bring the Energy Taxation Directive into line with the EU's energy and climate change objectives.

According to the EC, the existing Energy Taxation Directive contained four major drawbacks:

- The level of taxation is inconsistent between the various energy sources.
- The minimum levels of taxation are not properly related to the need to combat climate change.
- The development of renewable fuels requires specific measures to take into account the lower energy content of such products.
- The Energy Taxation Directive is not correlated to the ETS, thus leading to overlaps or loopholes.

The Basics of the New Paradigm

The Proposal reflects the policy of the EC to revise the structure of the Energy Taxation Directive to take into account different objectives behind energy taxation, i.e., revenue generation and energy savings on the one hand, and environmental considerations on the other.

Under the Proposal, taxes on energy would be split into two components: CO_2-Related Taxation and General Energy Consumption Taxation.

- **CO_2-Related Taxation:** A single minimum rate for CO_2 emissions (EUR 20/t CO_2) would be introduced for all sectors not covered by the ETS. This would provide a carbon price for those sectors of the economy (households, transport, smaller businesses and agriculture) that are outside the ETS.

  The CO_2-related part of taxation would be zero for all biofuels that comply with sustainability criteria. Such taxation will provide for a technology-neutral advantage for all low-carbon energy sources. Introducing CO_2-Related Taxation will also better align the Energy Taxation Directive to the ETS.

  Taxation will apply to all emitters not included in the ETS — those that are taxable now as well as all small installations excluded from the ETS, even if they use energy for purposes other than heating. At the same time, emitters included in the ETS will be exempt from the CO_2-Related Taxation, whatever the actual scope of the ETS might be.

- **General Energy Consumption Taxation:** Minimum tax rates for energy would be based on the energy content (EUR per Gigajoule, or "GJ," which is a metric measure of energy use that applies to all energy sources) rather than volume. This means that energy sources will be taxed on the basis of the amount of energy that they generate, and greater energy efficiency will automatically be rewarded. The energy component of the tax will help to remove current distortions for competing energy sources. One GJ would be taxed in the same way, regardless of the product producing it.

  For motor fuels, the minimum level of taxation is fixed at EUR 9.6 per GJ, which corresponds to the minimum rate applicable at the time for petrol minus the corresponding CO_2 component.

  For heating fuels, the current minimum level for electricity of EUR 0.15 per GJ (corresponding to approximately EUR 0.5 per MWh) will be applied to all the energy products used for heating, taking into account the energy content of the respective product.

The scope of energy taxation remains unchanged and comprises heating use and motor fuel use as well as consumption of electricity in similar situations.

Both CO_2-Related Taxation and General Energy Consumption Taxation would be combined to determine the overall taxation level of a product. Member States have the flexibility to set their own rates above the EU minimum, and design their own structure for these taxes.

This new paradigm will lead to an extensive reshaping of the text of the Energy Taxation Directive. Many of the current exemptions and derogations will either be repealed or modified.

Impact on Selected Sectors

The impact that the Proposal will have on the European automotive industry, which has invested massively in promoting diesel technologies, is discussed in the following section. This section focuses on the consequences the Proposal is likely to have on three selected sectors: biofuels, electricity and nuclear energy.

BIOFUELS

Currently, biofuels are taxed on the basis of volume, at the same rate as the fuel they are intended to replace, which often may bring a competitive disadvantage to them. Under the Proposal, biofuels would be taxed on the basis of their own energy content, which is anticipated to be lower than that of competing fuels. They would also be exempt from the CO_2-Related Taxation to better reflect their performance in reducing CO_2 emissions. However, this positive treatment is reserved to biofuels complying with relevant sustainability criteria as defined in the Renewable Energy Directive (2009/28/EC) and in the Fuel Quality Directive (2009/30/EC).

ELECTRICITY

Energy content-related tax will be levied at the point of consumption and the minimum rate will not be modified. The CO_2-Related Taxation could only be levied on the input fuels used to generate electricity, as electricity does not lead to emissions at the point of consumption. However, electricity

generation is, except for small electricity generation installations, subject to the ETS and will therefore be exempt from the CO_2-Related Taxation.

NUCLEAR ENERGY

The Proposal will not affect the treatment of nuclear energy. Electricity from nuclear sources is taxed at the point of consumption, like electricity coming from all other sources. Taxes on nuclear fuel, such as the one recently introduced in Germany or targeted for implementation in Belgium, fall outside the scope of the Energy Taxation Directive and are therefore not affected by the present revisions.

One Year After the Proposal: Is the Dream Coming True?

The Proposal faced difficulties throughout the year due to lack of consensus among the Member States and strong lobbying by related industries. Some of the EU Member States have strongly advocated against the Proposal, using procedural arguments such as a lack of legal basis or the possible lack of compliance with the subsidiarity principle (defined by Article 5 of the Treaty on European Union to mean that, other than in matters exclusive to it, the EU does not take action unless it is more effective than action taken at a national, regional or local level).

Member States' and industries' concerns were echoed by the European Parliament (EP), which the EC is required to consult in taxation matters. The EP follows a different path, tackling the absence of proportionality in the changes contemplated by the Proposal for motor fuel (and, in particular, diesel) taxation.

The matter was first discussed by the Parliament's economic and monetary affairs committee in November 2011. A resolution of the EP was adopted in first reading in April 2012. Although supportive of the Proposal in principle, the EP critics concentrated mainly on the following aspects:

- Increasing the level of taxation of diesel fuel may cause a major destabilising blow to the European automotive sector, which enjoys a competitive advantage with regard to diesel technologies. According to the EP's rapporteur, consideration of climate and environmental policy imperatives, however necessary, is not sufficient. Energy policy and industrial policy aims constitute equally critical challenges for the EU. Further, the EP pointed out that, according to recent experience, achieving the EU target for a reduction in CO_2 emissions will depend in part on increased use of vehicles with diesel engines, something the Proposal is likely to discourage.
- The Proposal represents a significant intervention by the EU in national fiscal policies with the determination of applicable tax rates (compared to threshold levels in the current directive). The EP proposes to curb the tax increase for LPG and other alternative fuels to create a comparative advantage necessary for the development of fuel-efficient technology.
- Any significant increase in energy prices might lead to inflation and, given the current shape of public finance in many Member States, it will be difficult for Member States to balance the effect with measures such as cuts of other tax rates. The EP, through its rapporteur, opposed the Proposal system for automatic increases in the minimum rates of taxation to follow price indexes or CO_2 price movements.

Next Steps and Actions

The EP's views are only further evidence of the absence of consensus in the matter. After the EP vote, the EC reiterated that its Proposal, as it is, is the best way forward. This disagreement is a concern given that the Proposal requires unanimity at the Council level for its approval.

The Proposal targeted 2013 as the implementation date for Member States to match the third phase of the ETS. A phase-in period for Member States to restructure their taxes and to allow national administrations, businesses and the energy sector the necessary time to adjust is foreseen. Long transitional periods for the full alignment of taxation of the energy content, until 2023, aim to leave time for the industry to adapt to the new taxation structure. However, this should not keep companies from assessing the impact of the Proposal and developing possible actions to comply with it. ◆

Fostering Wind Energy Development in the Great Lakes

J. Paul Forrester

J. Paul Forrester
Chicago
+1 312 701 7366
jforrester@mayerbrown.com

Following the precedent of the Obama administration's "Smart from the Start" initiative to speed offshore wind energy development off the Atlantic Coast, on March 30, 2012, the Obama administration[1] and five of the eight Great Lakes littoral states[2] signed a memorandum of understanding (MOU) intended to streamline the efficient and responsible development of offshore wind energy resources in the Great Lakes.

The related announcement states that the MOU will enhance collaboration between federal and state agencies to speed review of proposed offshore wind energy projects and, in particular, to develop an action plan that sets the priorities and recommended steps for achieving efficient and responsible evaluation of wind power projects in the Great Lakes region.

The announcement further states that unlocking the Great Lakes' offshore wind energy resources[3] could yield tremendous economic and environmental benefits throughout the region, and that these resources have the potential to produce more than 700 gigawatts of energy from offshore wind—approximately one-fifth of the total offshore wind potential in the United States.

The announcement notes that the development of even a small portion of the area's offshore wind potential could create tens of thousands of clean energy jobs and generate revenue for local businesses. These efforts are in line with the steps the Obama administration has taken to increase domestic energy production, including increased production of our nation's oil and natural gas resources—with domestic oil production higher than any time in the last eight years and natural gas at an all-time high.

Federal coordination of Great Lakes offshore wind energy development is generally seen as welcome, given that the primary federal permitting is undertaken by the US Army Corps of Engineers (USACE) under Section 10 of the Rivers and Harbors Act of 1899[4] and Section 404 of the Clean Water Act of 1977.

In relatively sharp contrast to the Atlantic Coast's Outer Continental Shelf (OCS), which is under exclusive federal jurisdiction—and benefits from the OCS's significant prior experience with oil and gas leasing—the littoral Great Lakes states have jurisdiction over the littoral lakebed, as well as the likely onshore transmission interconnection, and the permitting process in most states is either relatively immature or still being developed.

In Illinois, the recently established Lake Michigan Offshore Wind Energy Advisory Council[5] is required to report its findings and

recommendations to the governor and the general assembly of Illinois by June 30, 2012. The council is also charged with evaluating the following:

- The appropriate criteria for the Illinois Department of Natural Resources (DNR) to use to review applications for offshore wind development of Lake Michigan lakebed leases.
- The criteria for identifying areas that are favorable, acceptable and unacceptable for offshore wind development, including, but presumably not limited to, impacts to wildlife, protected habitats, navigation, commercial fisheries and recreational uses of Lake Michigan.
- A recommended process for ensuring public engagement in the DNR's process for leasing the Lake Michigan lakebed for offshore wind energy projects.
- Options for how the state of Illinois shall be compensated for Lake Michigan lakebed leasing.
- A summary of the lessons learned from other domestic and international offshore wind development experiences, including those related to public policy, regulatory and siting concerns for offshore wind development.
- Identification of local, state and federal authorities with permitting, siting or other approval authority for wind power development in Lake Michigan.
- Recommendations for needed state legislation and regulations governing offshore wind farm development.

Similar efforts are occurring in the other Great Lakes littoral states. Some of these efforts are more advanced than the Illinois efforts (others are less advanced), so coordination among these states would certainly be welcome to Great Lakes offshore wind energy developers and other interested parties. ◆

Endnotes

1 Including the White House Council on Environmental Quality, the US Department of Energy, US Department of Defense, US Department of the Army, Advisory Council on Historic Preservation, US Coast Guard, US Environmental Protection Agency and US Fish and Wildlife Service.

2 The states of Illinois, Michigan, Minnesota and New York and the Commonwealth of Pennsylvania. According to an Obama administration representative, the remaining littoral states of Indiana, Ohio and Wisconsin declined to participate but may join the MOU later.

3 A 2009 map by the National Renewable Energy Laboratory of the DOE showing the Great Lakes offshore wind resource as ranging from Good to Superb is available at: http://www.windpoweringamerica.gov/pdfs/wind_maps/us_windmap.pdf.

4 Although an important limit on the utility thereof is the revocable nature of the permit available thereunder.

5 Established under Illinois Public Act 97-0266 (2010).

Mayer Brown Global Energy News

Law360 Recognizes Mayer Brown Global Energy Attorneys As Rising Stars

Robert Goldberg

Robert S. Goldberg
Houston
+1 713 238 2650
rgoldberg@mayerbrown.com

Robert S. Goldberg of Mayer Brown's Houston office has earned a spot among Law360's top five project finance attorneys under 40 for his work on some of the most innovative project finance deals. As the co-head of the firm's renewable energy group, Mr. Goldberg has been particularly active in recent years during an explosion in renewable energy project finance work. Since 2006, he's worked on 30 so-called tax equity transactions—tax-oriented investments made by institutional investors, banks or insurance companies to monetize federal tax benefits in bringing renewable energy projects online. One such transaction is Hatchet Ridge, a 101-megawatt California wind farm that was the first leveraged lease financing of an operational wind farm since the early 1980s and was the first deal to utilize the investment tax credit for wind projects provided in the American Recovery and Reinvestment Act. Another project was Macho Springs, a 50.4-megawatt wind farm in New Mexico. Mr. Goldberg represented an institutional investor involved in the construction, term loan and structured equity financing of the highly structured transaction, which involved debt, tax equity, grants and bonds. According to Law360, clients turn to Mr. Goldberg for his mix of knowledgeable advice and skilled transaction execution. ◆

Pablo Ferrante

Pablo Ferrante
Houston
+1 713 238 2662
pferrante@mayerbrown.com

Global Energy partner Pablo Ferrante intended to return to his native Argentina after getting a few months of experience at a US law firm; but eight years later, his hard work and bicultural fluency have helped Mayer Brown establish a strong foothold in the Latin American energy market, earning him a spot as one of five attorneys under 40 to be honored by Law360 as a rising legal star in the energy practice area. Mr. Ferrante works in Mayer Brown's Houston office, where he represents oil and gas companies in domestic and cross-border mergers and acquisitions, joint ventures, exploration, drilling and production contracts, development projects and a variety of agreements. One of his current endeavors is representing Colombia's national oil company Ecopetrol in connection with a $3.3 billion modernization and expansion project for the Barrancabermeja Refinery, Colombia's largest oil refinery. Mr. Ferrante also recently represented Bioenergy, a Colombian energy company, on its agreement with Isolux Corsan for the engineering, procurement and construction of Bioenergy's $203 million ethanol plant in Puerto Lopez, Colombia. The plant will be the largest ethanol plant in the country, with the capacity to produce 480,000 liters of ethanol per day. And he represented Ecopetrol in the $510 million acquisition of a 9.2 percent interest in the K2 field—a deepwater producing field located in the US Gulf of Mexico—from Union Oil Co. of California, a subsidiary of Chevron Corp. He also regularly advises major global oil corporations, including Spain's Repsol, Mexico's Pemex, Angola's Sonangol and South Korea's Korea National Oil Corp and SK Innovation. ◆

Mayer Brown 2012 Global Energy Conference

Last May, we hosted our **7th Annual Global Energy Conference** in Houston titled, *Global Energy: The New Frontier*. The conference attracted record attendance with nearly 200 attendees, including energy industry executives and energy-related media.

Our panelists included key industry experts, Mayer Brown global energy partners and a senior advisor from the Mozambique government. They offered their insights into the new frontiers of the energy industry and provided in-depth discussions on the below topics.

- Shale Gas Issues and Mitigating Risk
- The Increasing Energy Activity in Africa
- US LNG Exports

We concluded our half-day conference with a keynote luncheon featuring Amy Myers Jaffe, Director of the Energy Forum at the Baker Institute, Rice University, and Associate Director of the Rice Energy Program.

Please go to the following link to view this year's presentations:
http://www.mayerbrown.com/Mayer-Browns-7th-Annual-Global-Energy-Conference.

We are already planning for an even bigger conference next year. ◆

About Mayer Brown

Mayer Brown is a global legal services organization advising clients across the Americas, Asia and Europe. Our presence in the world's leading markets enables us to offer clients access to local market knowledge combined with global reach.

We are noted for our commitment to client service and our ability to assist clients with their most complex and demanding legal and business challenges worldwide. We serve many of the world's largest companies, including a significant proportion of the Fortune 100, FTSE 100, DAX and Hang Seng Index companies and more than half of the world's largest banks. We provide legal services in areas such as banking and finance; corporate and securities; litigation and dispute resolution; antitrust and competition; US Supreme Court and appellate matters; employment and benefits; environmental; financial services regulatory & enforcement; government and global trade; intellectual property; real estate; tax; restructuring, bankruptcy and insolvency; and wealth management.

OFFICE LOCATIONS

AMERICAS
- Charlotte
- Chicago
- Houston
- Los Angeles
- New York
- Palo Alto
- Washington DC

ASIA
- Bangkok
- Beijing
- Guangzhou
- Hanoi
- Ho Chi Minh City
- Hong Kong
- Shanghai
- Singapore

EUROPE
- Brussels
- Düsseldorf
- Frankfurt
- London
- Paris

TAUIL & CHEQUER ADVOGADOS
in association with Mayer Brown LLP
- São Paulo
- Rio de Janeiro

ALLIANCE LAW FIRM
- Spain (Ramón & Cajal)

Please visit www.mayerbrown.com for comprehensive contact information for all Mayer Brown offices.

Mayer Brown is a global legal services provider comprising legal practices that are separate entities (the "Mayer Brown Practices"). The Mayer Brown Practices are: Mayer Brown LLP and Mayer Brown Europe – Brussels LLP, both limited liability partnerships established in Illinois USA; Mayer Brown International LLP, a limited liability partnership incorporated in England and Wales (authorized and regulated by the Solicitors Regulation Authority and registered in England and Wales number OC 303359); Mayer Brown, a SELAS established in France; Mayer Brown JSM, a Hong Kong partnership and its associated entities in Asia; and Tauil & Chequer Advogados, a Brazilian law partnership with which Mayer Brown is associated. "Mayer Brown" and the Mayer Brown logo are the trademarks of the Mayer Brown Practices in their respective jurisdictions.

© 2012. The Mayer Brown Practices. All rights reserved.

Attorney advertising

Americas | Asia | Europe | www.mayerbrown.com

MAYER • BROWN

0612