KING & SPALDING

Energy Newsletter

August 2015

DISPUTE RESOLUTION

International Arbitration

Falling Oil Prices Are Not the Only Deterrent to Investment in Mexico's Oil Fields

Jamie Miller

Mexico's first auction of shallow water blocks in eighty years fell well short of expectations. While some may cite a significant decrease in the price of oil from when the auction was first announced, others have criticized harsh provisions in the model contract including the exclusion of key disputes from its arbitration clause. More »

Oil & Gas Litigation

Texas Supreme Court Clarifies When Parties to an Oil and Gas Lease May Allocate Post-Production Costs by Agreement

William R. Burns and Martha B. Daniels

A recent Texas Supreme Court decision addresses the obligation of royalty holders to pay postproduction costs. More »

GOVERNMENT RELATIONS

Government Relations / Europe

EU Commission Consults Industry on EU Strategy for LNG and Gas Storage

Nina Howell

The European Commission launched a public consultation on an EU strategy for LNG and gas storage. The consultation is part of the Commission's strategy to explore the full potential of LNG and gas storage in the mid to long term and evaluate its important role in the EU's energy policy. More »

International Trade

A New Development Bank - A New Funding source and a New Way of Doing Things for Energy and Infrastructure Projects Globally

Alex Blomfield and Ivan Davydov

The BRICS countries have recently established the New Development Bank in the hope of funding energy and infrastructure development in emerging markets.
More »

Regulatory / Oil & Gas

EPA Offers a Methane "Carrot" in Advance of its Regulatory "Stick"

Cynthia Stroman

The EPA is proposing its Methane Challenge Program in an attempt to

Visit King & Spalding's Energy Blog at energylawexchange.com

Upcoming Events

The King & Spalding Energy Forum presents "Distress in the Oil Patch: A focus on the Legal Traps and Opportunities in a Lowe Price Environment." The program will take place mid-3rd quarter 2015.

In The News

King & Spalding Opens New Office in Tokyo More »

King & Spalding Ranked as a Leading Global Deal Advisor for Private Equity and M&A in First Half of 2015 More »

King & Spalding Advises ACWA Holding on Landmark Islamic

achieve voluntary methane emission reductions by the oil and gas industry. **More »**

Regulatory / Oil & Gas

Major Pipeline Safety Rulemakings Coming in 2015

Sara Peters

The Pipeline and Hazardous Materials Safety Administration faces reauthorization by Congress this fall and a short deadline to publish numerous new and significant proposed rules. **More »**

Government Relations / U.S.

Senate Finance Committee Approves Energy Tax Provisions; LNG Tax-Parity Provision Included in Highway Bill Extension

Michael A. Andrews, Thomas J. Spulak, and Lauren M. Donoghue

With recent action by the Senate Finance Committee, several key energy related tax provisions are one step closer to law, including an LNG tax provision, which would make LNG fuel more competitive with diesel fuel. **More »**

Editorial Contacts
Charles J. (Tim) Engel III
+1 202 661 7800
tengel@kslaw.com
View Profile »

Andrew M. Stakelum
+ 1 713 276 7341
astakelum@kslaw.com
View Profile »

About King & Spalding's Energy Practice

King & Spalding's energy practice has more than 300 lawyers in the U.S., Europe, the Middle East and Asia, giving King & Spalding one of the broadest and deepest benches of energy lawyers in the world. The firm is one of the most active law firms in the global energy industry advising and representing clients on a broad spectrum of transactions and disputes, and has received top rankings from *Chambers Global, Chambers USA, The Legal 500, The International Who's Who of Oil & Gas Lawyers, Euromoney's World's Leading Energy & Natural Resource Lawyers* and *The Best Lawyers in America.* For additional information, visit www.kslaw.com/practices/Energy.

The content of this publication and any attachments are not intended to be and should not be relied upon as legal advice. In some jurisdictions, this may be considered "Attorney Advertising." If you are not currently on our Energy Practice Group mailing list under your own name, and you would like to join to receive our monthly *Energy Newsletter* publication and to receive notices of future programs and occasional notices of legal developments in the industry, or wish to be taken off the distribution list for this Newsletter, you can make that request by submitting your contact information to Andrew Stakelum at astakelum@kslaw.com.

© 2015 King & Spalding

Financing for US$2 Billion Industrial Gases Project

More »

King & Spalding

Energy Newsletter

August 2015

DISPUTE RESOLUTION
International Arbitration

Falling Oil Prices Are Not the Only Deterrent to Investment in Mexico's Oil Fields

Jamie Miller

On July 15, Mexico auctioned 14 shallow-water exploration blocks. The auction marked the first time in nearly eight decades that private and foreign investors could directly participate in Mexico's exploration and production of oil reserves since the industry was nationalized in 1938. Despite Mexico's high expectations for this first round of bids, only two of the 14 Blocks were successfully tendered. A consortium of Mexico's newly formed Mexican Sierra Oil & Gas, Houston-based Talos Energy LLC, and United Kingdom's Premier Oil PKC successfully bid on both tendered Blocks.

Industry experts have provided various reasons for why the auctions fell well short of Mexico's expectations to tender at least a third of the Blocks in the first round of auctions. Not surprisingly, some cite plummeting oil prices. In December 2013, when Mexico amended its Constitution to allow for private investment in the oil sector, oil was trading at over US $100 a barrel. Eighteen months later, oil prices were less than half.

But falling oil prices are not the only hurdle to foreign investment. The model contract posted on Mexico's website[1] contains numerous provisions that that should give pause to foreign investors, even in a landscape of rising oil prices. Of particular concern are the harsh rescission provisions, which entitle Mexico's National Hydrocarbons Commission (CNH) to unilaterally terminate the contract if certain enumerated events occur. While some provisions are more standard—such as the failure to submit exploration plans or the failure to develop the fields in accordance with such plans—the model contract goes beyond international norms with regards to potential accidents or environmental incidents. According to Article 23.1(d), the CNH may administratively rescind contracts if "a serious accident occurs as result of the Contractor's willful misconduct or fault which causes damage to the facilities, loss of life or loss of production."[2] This broad provision arguably entitles the CNH to rescind a contract in the event of an environmental incident such as a spill or blowout, if such an incident causes damages to the facilities or a loss of production.

In response to criticism regarding this provision, Mexico's Deputy Energy Minister Lourdes Melgar emphasized that rescission would only be possible in the event of a "serious accident."[3] But such words should provide potential investors little comfort, especially in light of the Model Contract's provision that carves out "disputes . . . in any way arising from or related to the events of administrative rescission" from the UNCITRAL arbitration clause.[4] In other words, disputes regarding improper administrative rescission are to be litigated not through international arbitration, but exclusively by the Federal Courts of Mexico pursuant to Model Contract Article 26.4.

---

[1] The Model Contract for individual companies is available at ronda1.gob.mx/English/pdf/PDF-L-01/R01L01_Individual-contract_20141211.pdf.

[2] *See* Model Contract Article 23.1 (d).

[3] David A. Garcia, *Tough Contract Rescission Clauses Could Blunt Mexican Oil Opening*, Reuters, July 2, 2015, af.reuters.com/article/energyOilNews/idAFL2N0ZF1RY20150701.
[4] Model Contract Article 26.4.

Jamie Miller
Houston
+1 713 276 7445
jamiller@kslaw.com
View Profile »

The content of this publication and any attachments are not intended to be and should not be relied upon as legal advice.

KING & SPALDING

Energy Newsletter

August 2015

DISPUTE RESOLUTION
Oil & Gas Litigation

Texas Supreme Court Clarifies When Parties to an Oil and Gas Lease May Allocate Post-Production Costs by Agreement

William R. Burns and Martha B. Daniels

The Texas Supreme Court recently decided *Chesapeake Exploration, L.L.C. v. Hyder*, providing a notable win for royalty interest holders. In a close 5-4 decision, the Texas Supreme Court held that Chesapeake had improperly deducted postproduction costs from the overriding royalty interest. *Chesapeake Exploration, L.L.C. v. Hyder*, 14-0302, 2015 WL 3653446 (Tex. June 12, 2015). The general rule in oil and gas lease interpretation is that an overriding royalty is free of production costs, but *not* postproduction costs—such as transferring and delivering oil or gas produced under the lease. In *Chesapeake*, however, the Court found that the lessee failed to establish that certain lease language provided that the overriding royalty holder should bear postproduction costs. This finding was based on several separate provisions in the lease.

First, the lease included a provision establishing a "a perpetual, cost-free (except only its portion of production taxes) overriding royalty. . ." *Id*. at 3. The Court disagreed with Chesapeake's argument that "cost-free overriding royalty" was simply a "synonym for overriding royalty." *Id*. at 6. The Court ultimately concluded that the provision "cost-free" meant to exclude postproduction costs from the overriding royalty; however, the Court also held that this clause was not dispositive of the issue. *Id*. at 7.

The Court next looked at the lease provision allowing the overriding royalty interest to take in kind. If the royalty holders elected to take in kind, by taking their share of the produced oil or gas at the well, they would therefore be responsible for postproduction costs. But even though the royalty holders *might* be subject to postproduction costs, this did "not suggest that they must be subject to those costs when the royalty is paid in cash." *Id*. at 8.

Finally, the Court reviewed the lease provision disclaiming the application of *Heritage Resources, Inc. v. NationsBank*, a Texas Supreme Court decision from 1996. In *Heritage Resources*, the Court had noted that a royalty is "*usually* subject to post-production costs, including taxes . . . and transportation costs." 939 S.W.2d 118, 122 (Tex. 1996) (emphasis added). But the Court explained that "*Heritage Resources* does not suggest, much less hold, that a royalty cannot be made free of postproduction costs. It holds only that the effect of a lease is governed by a fair reading of its text." *Id*. at 10. The Court further noted that "[a] disclaimer of that holding, like the one in this case, cannot free a royalty of postproduction costs when the text of the lease itself does not do so." *Id. The disclaimer of Heritage Resources thus did not influence the Court's decision.*

The holding in *Chesapeake* has repercussions for the oil and gas industry in Texas. Operators negotiating leases should be cautious consenting to "cost-free" language that could unintendedly release royalty owners from sharing the burden of post-production costs. Parties should also be aware that disclaiming *Heritage Resources*,

by itself, is not sufficient to free a royalty of post-production costs if the lease language does not otherwise do so.

William R. Burns
Houston
+1 713 276 7333
bburns@kslaw.com
View Profile »

Martha B. Daniels
Houston
+1 713 276 7305
mdaniels@kslaw.com
View Profile »

The content of this publication and any attachments are not intended to be and should not be relied upon as legal advice.

KING & SPALDING

Energy Newsletter

August 2015

GOVERNMENT RELATIONS
Government Relations - Europe
EU Commission Consults Industry on EU Strategy for LNG and Gas Storage
Nina Howell

Introduction

On 8 July 2015 the European Commission launched a public consultation on an EU strategy for liquefied natural gas (LNG) and gas storage. The consultation is part of the Commission's strategy to explore the full potential of LNG and gas storage in the mid to long term, and to assess the potential role of LNG in the EU's energy mix, and in enhancing security and competiveness of supply in the EU. The consultation seeks the views of stakeholders on the challenges and opportunities for LNG in the EU by 30 September 2015.

The Commission stated that the "The EU Communication commits us to developing a comprehensive LNG and storage strategy that will explore the full potential of LNG and gas storage in the mid-to-long term, and to identifying how it can enhance security and competitiveness of supply."

EU Security of Supply

The completion of a single, integrated, transparent and interconnected energy system in the EU is imperative for the European Commission. In its Work Programme 2015, the Commission identified a "resilient energy union with a forward looking climate change policy" as a priority. The Commission stated that it intends to adopt a strategic framework for the Energy Union that will not only ensure energy supply security and reduce dependence on imports from third countries, but will further integrate national energy markets and improve participation of consumers, enhancing energy efficiency and decarbonising the energy mix through the promotion of research and innovation. The Commission is fundamentally concerned with the supply of secure, sustainable, competitive and affordable energy for consumers, households and businesses.

It is evident that the EU's prosperity is ultimately contingent upon a stable, abundant and competitively priced supply of energy. Thus, the diversity of fuels, suppliers and supply points is integral to ensuring EU energy security. The EU currently imports approximately 53% of the energy it consumes at a cost of more than €1 billion per day. Energy also makes up more than 20% of total EU imports, with EU Member States (across the board) importing about 90% of their crude oil and 66% of their natural gas. Despite the fact that EU oil consumption is decreasing (13% 2005-2012) it remains the largest single primary energy source within the EU. This dependence leaves the EU exposed to the adversities inextricably linked with the global oil market such as supply shortages, price shocks and thus supply disruption. However, it is the EU's dependency on gas imports that is the greater source of concern for the Commission. Nine EU member states have 100% gas import dependency with Russia as the single source of imported gas to Finland, Estonia, Latvia, Lithuania,

Czech Republic and Bulgaria. Russia supplies 33% of Europe's oil and 39% of its gas; and such a strong dependence on a single external supplier poses an ever increasing threat to the security of Europe's gas supply.

EU LNG Regasification Capacity

There are currently 23 LNG terminals in Europe with 5 under construction and a further 32 being considered (with varying degrees of progress). Total regasification capacity in Europe's 23 LNG terminals is approximately 200 bcm/year at the end of 2013 with its main capacities in Western Europe. However, average capacity utilisation rates in European regasification terminals have fallen dramatically since 2009 and are much lower than pipelines (at about 25%). One of the primary reasons for low utilisation rates was a stagnant demand for natural gas in Europe due to subsidised renewables and the continued supply of cheap coal that dominate the market.

Despite current low utilisation rates in Europe's LNG import terminals, with falling oil prices and huge quantities of LNG liquefaction taking place in the US and Australia, the Commission stated that work should be progressed in developing liquid gas hubs in Central and Eastern Europe and in the Mediterranean area. The Commission's strategy will also identify the necessary transport infrastructure linking LNG access points with the internal market. The Commission will also explore the potential of gas storage in Europe; the regulatory framework needed to ensure sufficient gas in storage for winter; and it will work to remove obstacles to LNG imports from the US and other LNG producers. The Commission will also support the construction of the infrastructure needed to deliver new sources of gas to the EU through the use of all available community funding instruments.

EU Projects of Common Interest

To aid the creation of an integrated EU energy market, the European Commission has drawn up a list of 248 projects of common interest (PCIs). The European Commission has identified 27 PCIs in gas as critical for EU's energy security. PCIs include North- South gas interconnections in Central Eastern and South Eastern Europe to connect the Baltic, Adriatic, Aegean and Black Seas. It is estimated that €40 billion will be required to upgrade and build new gas interconnectors. The PCIs include twelve possible LNG import terminals (some to be co-financed with dedicated EU funds from the Connecting Europe Facility (CEF)) to be located in Croatia, Estonia, Greece, France, Ireland, Latvia, Poland and Sweden.

It will be interesting to evaluate the responses to the Commission's consultation. It is possible that the low utilisation rates in the EU's existing LNG import terminals will deter some investors from participating in new EU LNG projects, and it is expected that most of the proposed new EU LNG projects will need significant EU funding to be constructed.

Nina Howell
London
+44 20 7551 7543
nhowell@kslaw.com
View Profile »

The content of this publication and any attachments are not intended to be and should not be relied upon as legal advice.

KING & SPALDING

Energy Newsletter

August 2015

GOVERNMENT RELATIONS
International Trade

A New Development Bank - A New Funding source and a New Way of Doing Things for Energy and Infrastructure Projects Globally

Alex Blomfield and Ivan Davydov

Introduction

On 7 July the five BRICS countries of Brazil, Russia, India, China, and South Africa formally launched the New Development Bank (NDB) at the inaugural meeting of the institution's Board of Governors in Moscow, Russia, ahead of the Seventh BRICS Summit held in Ufa, Russia on 8 & 9 July. The NDB opened its doors at its head office in Shanghai, China on 21 July. The NDB promises to provide not only a new source of funding for energy and other infrastructure projects globally but to also represent a new way of providing such funding. This article examines the rationale for the new institution and outlines some of its key features and its implications for funding energy and infrastructure projects.

Why a new bank?

Former Goldman Sachs Chief Economist Jim O'Neill coined the term BRIC more than a decade ago, which did not initially count South Africa among the ranks of the major emerging economies. Excluding South Africa, the four original BRIC countries today make up more than 40 per cent of the world's population, a quarter of the world's land area and more than 25 per cent of global gross domestic product. The member countries have always had quite different economies but a common feature has often been a high rate of savings. Thus, London School of Economics Professor Nicholas Stern and former World Bank chief economist Joseph Stiglitz came up with the idea of a new development bank at Davos in 2011 as a way for emerging markets with large trade surpluses to recycle those savings into productive investments in their own countries, such as infrastructure.

Another reason behind the establishment of the NDB lies in the BRICS countries' frustration in the World Bank's and the International Monetary Fund's (IMF) delay in reforming their procedures so that voting weight and influence are more commensurate with economic size and contributions to such bodies. For example, the BRICS nations account for more than 25 per cent of global economic output, but have 10.3 per cent of quota in the IMF. European countries, on the other hand, have 27.5 per cent of the voting weight, but make up 18 per cent of global economic output. Compounding this inequality are archaic rules that require a European to always head the IMF and an American the World Bank. Against this context, the NDB represents, together with the Beijing-based Asian Investment Infrastructure Bank (AIIB), a financing alternative to the Bretton Woods institutions of the IMF and the World Bank that have underpinned the global economic order since their founding in 1944.

Establishment of the NDB

India formally proposed the idea to establish a dedicated BRICS bank at the fourth BRICS summit in New Delhi, India in 2012. Articles of Agreement were signed during the sixth BRICS summit in Fortalezza, Brazil, on 15 July 2014 and these entered into force in June 2015 following submission by each BRICS country of documents of acceptance, ratification or approval. As mentioned above, the initial 7 July Moscow meeting of the Board of Governors of the BRICS NDB, which includes finance ministers of the member countries, formally launched the $100 billion new institution. The 8-9 July Ufa summer also formalised the launch of a currency reserve pool (the Contingent Reserve Arrangement) worth another $100 billion USD. Rules regarding procedures and the NDB's five-year development strategy were discussed at the Moscow and Ufa meetings.

Purpose and Functions of the NDB and the Contingent Reserve Arrangement

The bank has a mandate to finance infrastructure and sustainability projects in BRICS and other emerging and developing countries "to complement the existing efforts of multilateral and regional financial institutions for global growth and development". The NDB mandate clearly indicates that it should be involved in projects where private capital is not capable or unwilling, as the case may be, to make major investments due to potential low profitability and long payback periods.

The Contingent Reserve Arrangement is designed to allow the BRICS countries to draw funds during a crisis. In particular, if problems arise providing dollar liquidity to national financial systems, BRICS central banks will support the partner by transferring a sum in US dollars on agreed serviceability and repayment terms. China has pledged to contribute a total of $41 billion USD to the Contingency Reserve Arrangement, giving it the largest share of voting rights at 39.5 per cent.

Focus and approach

The BRICS bank has a global mandate, as opposed to the AIIB, which is exclusively focussed on Asia. The NDB will finance projects in member countries and eventually other developing nations through loans, guarantees, credit and equity investments. Broadening the membership to other countries will be considered in coming months. The NDB's priorities will be in line with national development banks of member countries, including the removal of infrastructural constraints for growth. There are signs that energy will be a key focus of activity for the bank, as well as infrastructure projects that fall within China's "One Belt, One Road" concept for improving connectivity in Eurasia.

The NDB has said that it will be guided by four defining principles: it will be professional, efficient, transparent and green. "Professional" should reassure the international community that the NDB will be properly run as a global rules-based (rather than political) institution, even with a focus on "next practice, not best practice." "Efficient" echoes the AIIB's desire to be "lean" – both institutions will have a leaner management structure than the World Bank and aim at faster decisions. What is meant by "transparency" remains unclear, as do related issues concerning the appropriate level of disclosure to the public of decisions and the processes that lead to such decisions. "Green" reflects a desire to uphold environmental standards and place renewable energy and clean technologies at the core of the NDB's business model. In that vein, India's President Modi has stated that he wants the first project of the NDB to be a renewable energy project.

Initial Capital and Governance

The NDB will have a Board of Governors, a Board of Directors, a President and Vice-Presidents. The President of the Bank will be elected from one of the founding members on a rotational basis, and there will be at least one Vice-President from each of the other founding members. India's K.V. Kamath, the non-executive chairman of ICICI Bank and a former chairman of Indian IT major, Infosysis, has begun his term as the Bank's inaugural President. He will be followed in the office by a Brazilian and then a Russian. A Chinese national will not lead the bank until 2021.

The NDB's initial authorised capital equals $100 billion USD. The BRICS countries have agreed that the bank's subscribed capital would amount to $50 billion USD, of which only $10 billion USD would actually be paid in (each of the BRICS member countries would contribute $2 billion USD within a seven year period according to an established schedule).

The voting power of each NDB member will equal its subscribed shares in the capital stock of the bank. Since the initial subscribed capital ($50 billion USD) is equally distributed amongst the founding members, each member state will have an equal twenty per cent share in the bank's capital and, consequently, equal voting rights (at least in the beginning). The voting calculation mechanism that ensures that NDB members have equal voting rights or, as the case may be in the future, voting rights proportionate to their actual shares, is the key feature that differentiates the NDB from other international financial institutions, such as the World Bank and the IMF.

HSES Standards

Little has been made public about the health, safety, environmental and social norms of the NDB. However, Lou Jiwei, Chinese finance minister, has stated he believes the NDB can improve upon existing norms. "This bank will place greater emphasis on the needs of developing countries, have greater respect for developing countries' national situation, and more fully embody the values of developing countries," said Mr. Lou. "Development is a dynamic process. There's really no such thing as so-called 'best practices'." Indeed, Mr. Kamath has pledged to move the bank "from best practices to next practices", and has described traditional development lending as often "too rigid, inflexible, and slow".

Bribery and corruption

Comparisons between the NDB and the recently established Asian Infrastructure Investment Bank are inevitable. The broader AIIB membership will pressure that institution to uphold international rules and norms relating to bribery and corruption, such as the OECD Anti-Bribery Convention (1997) – based on the U.S. Foreign Corrupt Practices Act of 1977 – and the IFC Anti-Corruption Guidelines. That pressure will be missing for the NDB and it remains to be seen what rules (if any) the bank will adopt in respect of bribery and corruption, though it has committed in general terms to transparency.

Currency

Recently, there has been much discussion of bilateral trade among certain BRICS countries switching to national currencies instead of the US dollar, which remains the default currency for global trade, even among BRICS countries. In particular, Russia and China have agreed to use each other's currencies to promote bilateral trade and investment, with Russian President Putin saying that Moscow would be keen to expand the use of national currencies with other BRICS countries. However, notwithstanding these political pronouncements and some increased use of national currencies, it seems clear that the NDB's basic currency, at least for the foreseeable future, will remain the US Dollar. Indeed, the capital of the NDB is denominated, and is supposed to paid by the bank's members, in US dollars, and the Contingent Reserve Arrangement is sized at 100 billion USD, thereby implying provision of US dollar liquidity to the members of the Contingent Reserve Arrangement. Notwithstanding the foregoing, Mr. Kamath has foreshadowed that the NDB's first loan will be made in Chinese Renminbi (RMB) and stated that the NDB will encourage local currency credit to protect the BRICS countries from currency fluctuations and volatility.

Working with other institutions

The NDB follows the establishment of two other China-led institutions over the past year: the AIIB and the Silk Road Fund (SRF). Some commentators see this trio of new institutions as ushering in a new world economic order. However, Russian President Putin has said that the NDB will complement, not replace, existing global institutions; and this reflects the Bank's mandate set out in its Articles of Agreement. The fact that all BRICS countries are now founding members of the AIIB could also help the NDB develop a consistent and complementary relationship with that organisation.

The heads of the World Bank, Asian Development Bank and African Development Bank have shared encouraging words that indicate a desire to cooperate with the NDB. These words from Asian Development Bank President Takehiko Nakao are indicative of their attitude: "We look forward to working with this new member of the global family of multilateral development banks in areas of common interest in Asia and Pacific, including possible co-financing for infrastructure and projects promoting sustainable development, utilising our long experience and expertise in the region". Although the NDB has made clear that it will seek a new way of operating compared to established development finance institutions, true partnership rather than competition with such institutions will mean that the NDB would not turn its back on what their knowledge and experience can offer it as a new institution.

At the recent BRICS meeting in Ufa, Russia, development banks of each of the BRICS countries (BNDES, Vnesheconombank, Export-Import Bank of India, China Development Bank Corporation and Development Bank of Southern Africa Limited) entered into a Memorandum of Understanding to engage in interaction with the NDB within the areas of infrastructure and sustainable development as well as other areas of mutual interest including: (i) agreements, including loan facilities, currency swaps and issuance of bonds; (ii) joint programs for project finance; (iii) information sharing on potential projects, and mechanisms for project monitoring; (iv) guarantees and counter-guarantees to secure obligations, including in respect of securities issued by the parties; (vi) investment funds to finance projects in sectors and industries that are a priority for the parties; (vii) experience and knowledge sharing through consultations, conferences and round tables; and (viii) regular dialogue and meetings between the parties and the NDB.

More projects, faster

Against the background of enormous capital outflows from China in recent months and the faltering growth of the Russian, Brazilian and South African economies, it is a difficult time for the BRICS economies. The establishment of the NDB offers a piece of good news, a chance to shape a new nimble and responsive institution that can offer an alternative to the energy and infrastructure funding needs of the BRICS economies. The hope is that the NDB will lead to more projects, faster.

Alex Blomfield
London
+44 20 7551 2142
ablomfield@kslaw.com
View Profile »

Ivan Davydov
Moscow
+7 495 228 8516
idavydov@kslaw.com
View Profile »

The content of this publication and any attachments are not intended to be and should not be relied upon as legal advice.

KING & SPALDING

Energy Newsletter

August 2015

GOVERNMENT RELATIONS
Regulatory / Oil & Gas

EPA Offers a Methane "Carrot" in Advance of its Regulatory "Stick"

Cynthia Stroman

On July 23, 2015, the United States Environmental Protection Agency (EPA) issued its proposed framework for the Natural Gas STAR Methane Challenge Program.[1] Intended to encourage voluntary "beyond (current) compliance" methane emission reductions, the program will provide a mechanism for oil and gas companies to make and track methane emission reduction commitments.

Background

In January 2015, the Obama Administration announced significant goals for reducing methane emissions from the oil and gas sector – 40-45% reduction from 2012 levels, to be achieved no later than 2025. The announcement indicated that both voluntary and mandated reductions would factor into the action plan for achieving the goal. The Methane Challenge Program proposes to deliver on the first half - voluntary reductions. EPA proposes to expand on the existing Natural Gas STAR program by using Subpart W of the Greenhouse Gas Reporting Program (GHGRP) data, plus supplemental voluntary submissions to track performance at a company level, not just program level.

The Proposal

The Methane Challenge Program seeks voluntary commitments from companies engaged in onshore oil production and the entire natural gas value chain (from production through distribution). Sources targeted by the program include pneumatic controllers, leaks/fugitives, liquids unloading, compressors, storage tanks, pneumatic pumps, and other emissions sources. The proposal offers two options – the Best Management Practices (BMP) Option and the One Future Option.

Proposed BMP Option Requirements:

Companies that select the BMP Option would:

- Commit to reductions from at least one source
- Set a target compliance date no later than 5 years
- Utilize the BMPs outlined for each type of source

EPA is considering some flexibility mechanisms in the implementation of this option. One mechanism would allow companies in some segments to define "company-wide" as a division or business unit. The Agency also intends to allow for additional BMPs from time to time.

Proposed One Future Option Requirements:

In the proposal, EPA offers an alternate track for companies that make a commitment through One Future, Inc., an industry organization that requires members to commit to and achieve 1% or less "leakage rate" along the natural gas value chain by 2025. Like the BMP Option, One Future offers a menu of tools to achieve the organization's objective.

Elements Common to Both Options:

EPA intends the options to operate in parallel, with similar administrative requirements. Companies would sign a memorandum of understanding with their chosen organization (EPA or One Future) and their commitments would be announced by the organization. Participants would submit their implementation plans within six months after signup, and make annual submissions of voluntary supplemental data for online progress tracking.[2] Companies can elect both options if it better fits their structure, although the One Future option is better suited for companies concentrated in subsegments of the natural gas value chain.

Opportunities for Stakeholder Feedback

The Agency is seeking general feedback on the program, but there are certain issues that provide opportunity for strategic input:

- How should EPA incentivize companies to participate in the voluntary program? Particularly, how should participation in the Methane Challenge Program be recognized and rewarded in the regulatory program?[3]
- For the BMP option, are there additional BMPs that should be included on the initial list?
- Are there low-emission sources that should be exempted from a "company-wide" definition because BMP implementation is impracticable?
- For BMPs related to leaks and fugitive emissions, how could the program align frequency of monitoring and repair with existing practice?

Stakeholder feedback on these and other issues is due September 1, 2015, either online or through meeting with EPA. The Agency intends to finalize the program, seek charter partners, and launch the program by the end of 2015.

---

[1] EPA, Natural Gas STAR Methane Challenge Program: Proposed Framework, Proposal for Stakeholder Feedback (July 23, 2015) (hereinafter "Methane Challenge Proposal").

[2] "Supplemental data" includes information from companies not subject to GHGRP reporting because their emissions are less than 25,000 $MTCO_2e$ or sources not covered by GHGRP.

[3] EPA intends to issue its proposed regulatory program in the next months.

Cynthia Stroman
Washington, DC
+1 202 626 2381
cstroman@kslaw.com
View Profile »

The content of this publication and any attachments are not intended to be and should not be relied upon as legal advice.

KING & SPALDING

Energy Newsletter

August 2015

GOVERNMENT RELATIONS
Regulatory / Oil & Gas

Major Pipeline Safety Rulemakings Coming in 2015

Sara Peters

Authorization of the federal pipeline safety programs will expire on September 30th of this year. With this looming deadline, the Pipeline and Hazardous Materials Safety Administration (PHMSA) is scrambling to finish the 42 mandated rulemakings and studies required by the 2011 Pipeline Safety, Regulatory Certainty, and Job Creation Act (Pipeline Act).

To-date, PHMSA has completed only 26 of the mandates, leaving some of the most controversial issues unfinished, including rules on the use of automatic and remote-controlled shutoff valves; expansion of the integrity management program (IMP) requirements; maximum allowable operating pressure (MAOP) verification; and additional regulation of hazardous liquids lines.

In the past month alone, PHMSA issued two Notices of Proposed Rulemakings, which began the rulemaking process for three of the 2011 mandates: (1) expanding the use of excess flow valves in gas distribution systems, 80 Fed. Reg. 41460 (Jul. 15, 2015); (2) incident notification, 80 Fed. Reg. 39916 (Jul. 10, 2015); and (3) cost recovery for design reviews, *id.* PHMSA also issued a final rule last month, which finalized an even earlier mandate – from the 2006 pipeline safety authorization act – to address pipeline damage prevention programs. 80 Fed. Reg. 43836 (Jul. 23, 2015).

Congress recently called upon PHMSA to explain its delays in implementing the 2011 Act. During a hearing on July 14th before the House Energy and Commerce Committee, Subcommittee on Energy and Power, Members from both parties expressed frustration with PHMSA's delays. Some stated there is no excuse for a four-year delay on some of the easy mandates set forth in the Pipeline Act, such as the requirement that PHMSA change the incident notification rule to no later than 1 hour within a confirmed discovery.

Members also were concerned that PHMSA's proposed rules languish at the White House Office of Management and Budget (OMB) during OMB's review of the rules for cost-benefit effectiveness. PHMSA's authorizing statute requires that benefits exceed costs in all of its rulemakings. The rules proposed earlier this month demonstrate the difficulty PHMSA and OMB face in satisfying this requirement: the benefits do not exceed costs, unless "unquantified" environmental and health benefits are factored in.

Congressional frustration with PHMSA may lead to a shorter-term reauthorization this year, rather than the typical several-year authorization bills for pipeline safety programs. Congress will want to keep PHMSA's "feet to the fire" with authorization deadlines and will want time to assess the new regulations before authorizing new programs.

Industry observers believe that PHMSA intends to release a "mega-rule" on pipeline safety – containing several major final rules in one – by fall of this year.

When asked what progress PHMSA is making on the outstanding mandates, Interim Executive Director Stacy Cummings offered the following insights: (1) a gas and hazardous liquids rule will be completed by the end of the year; (2) IMP requirements will be expanded into other types of operations and assessment of new technologies will be added to IMP over the next year; and (3) the leak detection and valves rules are being evaluated now. Cummings would not commit to a schedule beyond that, and she would not prioritize any particular rule over another, saying they are all important and PHMSA has "a plan" to finish all of the mandates.

In the meantime, while awaiting final rules, Cummings said PHMSA is using Advanced Notices of Proposed Rule Makings, safety advisories, and other means to get information out to stakeholders quickly, even when the rulemaking process is slow. As an example, she noted PHMSA is planning an IMP risk assessment workshop soon with other industries, such as aviation, to gather and push out best practices to the pipeline industry. Cummings also testified that industry standards – such as API 1173, a recommended practice regarding pipeline safety management systems published earlier this month – can fill regulatory gaps.

Regarding the upcoming reauthorization bill, Cummings said PHMSA would like to work with Congress to obtain more information for the National Pipeline Mapping System (NPMS) information, so that PHMSA can better understand how products are transported and apply various analytics to that data to evaluate risk.

Sara Peters
Washington, D.C.
+1 202 626 2951
speters@kslaw.com
View Profile »

The content of this publication and any attachments are not intended to be and should not be relied upon as legal advice.

KING & SPALDING

Energy Newsletter

August 2015

GOVERNMENT RELATIONS
Government Relations / U.S.

Senate Finance Committee Approves Energy Tax Provisions; LNG Tax-Parity Provision Included in Highway Bill Extension

Michael A. Andrews, Thomas J. Spulak, and Lauren M. Donoghue

Pathway to Passage for Tax Extenders

On July 21, the Senate Finance Committee approved by a vote of 23 to 3 a bipartisan tax bill to renew for two years more than 50 expiring and expired tax provisions known as "tax extenders." These provisions generally provide tax benefits designed to incentivize particular behavior from American taxpayers, *e.g.*, the use of renewable energy. As originally enacted, most of these provisions are designed to be temporary incentives and remain in effect for short periods of time, primarily because of their high costs and their impact on the federal budget. Thus, if not "extended" they will permanently expire.

While some would prefer that these provisions either be permanently enacted or otherwise eliminated entirely, in order to provide certainty in the tax code for the next two years and encourage economic growth and development, innovation, and job creation, the Finance Committee once again took this stopgap approach. If approved by Congress, the legislation could cost the federal government an estimated $95 billion over the next 10 years, according to the Joint Committee on Taxation. The Finance Committee has indicated that it will use a broad reform of the tax code in the next few years as a way of determining the long-term fate of these provisions.

Energy Extenders Legislation

Many of the provisions in the extender legislation provide energy-related tax breaks designed to help support American energy jobs, a cleaner environment through renewable energy projects, and energy independence for the United States. For example, the bill includes a two-year extension of the Production Tax Credit ("PTC") for wind, geothermal, biomass, and landfill gas projects, giving developers an additional two years to begin construction, and maintaining the existing option either to claim production tax credits or a 30 percent investment tax credit on relevant projects. A bipartisan amendment, which failed to be included in the final bill, would have allowed renewable energy and energy storage projects to create master limited partnerships, which are businesses organized as partnerships or limited liability companies ("LLCs") and publicly traded, offering capital markets investors the tax benefits of partnerships.

What's Next For Tax Extenders?

The tax extenders bill now moves to the Senate floor where it is believed that much of the bill reported out of the Finance Committee will be preserved. Some provisions, however, such as the wind energy production tax

credit, are already under attack and may not survive. Those provisions that do pass will be sent to the House, which is considering a different approach.

The House has signaled that it is ready to put an end to the biannual exercise of extending these provisions by deciding to make some of the expired and expiring provisions permanent and allowing others to fall out of the tax code. Accordingly, it is expected to consider a package of permanent tax extenders as part of a broader effort to reform the U.S. tax code when Congress returns from its August recess. According to the Joint Committee on Taxation, making the tax extenders permanent would add more than $1 trillion to the budget deficit by 2025. President Obama has indicated he will veto legislation that makes tax extenders permanent without providing offsets.

LNG Industry Is A Winner

As a new and important player in the nation's developing domestic energy market, the liquefied natural gas ("LNG") industry is a big winner in recent congressional action. The tax extenders bill included a significant tax cut that would equalize the taxation of LNG compared to diesel based on energy production per gallon. The provision changes the tax rate of LNG to a rate based on its energy equivalent of a gallon of diesel fuel (approximately 14.1 cents per gallon) and allows LNG to compete equally with diesel by taxing LNG on energy output rather than on a per gallon basis.

Currently, LNG and diesel fuels are taxed at the same 24.3 cent per gallon rate, although a gallon of LNG produces approximately 58 percent of the energy produced by a gallon of diesel fuel. This inequality within the tax system results in thousands of dollars of additional costs for companies that choose to use LNG, despite the fact that LNG produces significantly lower levels of toxic emissions than diesel and reduces pollution from black carbon, a major contributor to climate change.

The LNG equalization provision was included as part of the short-term highway funding bill that passed the Senate on Thursday, July 30. Senator Richard Burr (R-NC), who introduced the provision along with Senator Michael Bennet (D-CO), stated that the legislation "is sorely needed so that we're not unfairly punishing consumers with higher taxes for choosing cleaner fuels." The short-term highway bill passed the House the day before Senate passage and President Obama is expected to sign the bill into law. The LNG provision will apply to any sale or use of fuel after December 31, 2015.

Michael A. Andrews
Washington, D.C.
+1 202 626 5609
mandrews@kslaw.com
View Profile »

Thomas J. Spulak
Washington, D.C.
+1 202 661 7948
tspulak@kslaw.com
View Profile »

Lauren M. Donoghue
Washington, D.C.
+1 202 626 8999
ldonoghue@kslaw.com
View Profile »

The content of this publication and any attachments are not intended to be and should not be relied upon as legal advice.