Global Regulatory Update

Europe full of Energy

Europe is at a fascinating crossroads in its political and therefore legal development as it faces the challenges of 2006. Despite the rejection of the European Constitution by the voters of France and Holland last summer it remains clear that the drive to statehood remains a priority for the European body politic and is generally supported by member states' national leaderships.

As a result the drive to create an integrated European marketplace can be expected to continue and key sectors will be energy and the environment, where even critics of integration agree transnational strategies are vital.

So activity in the European legal sector is expected to focus on two areas – further steps to open national markets to competition and the introduction of measures to address security of supply issues.

The Commission's report on the functioning of the EU energy markets is expected in Q1 of 2006. The Commission may subsequently propose necessary structural, regulatory and competition law remedies to remove obstacles to competition across the European markets.

In Germany, the newly-created regulatory authority, will be addressing the task of reviewing the third party access regime for the gas and electricity networks, as well as submitting a proposal for price/revenue regulation to Parliament in 2006 and implementing a new entry-exit system for the gas network. Meanwhile, in France there are expected to be a number of decrees implementing the 2005 energy law, addressing issues such as diversity of sources of energy supply (with an emphasis on renewables) and control of energy demand.

In Poland the unbundling of the Oil and Gas Company will be completed in 2006 with the government expected to begin the process of the planned vertical integration, and subsequent flotation, of the major electricity companies, while also addressing the long-term power purchase agreements which are currently in place between certain generators and the grid company.

In the UK, high gas and electricity prices, combined with an imbalance in the level of market opening across Europe, means that the British regulator, Ofgem, will be increasingly active in challenging rules or activities which encourage high prices.

The other big issue for 2006 is likely to be the re-emergence of nuclear as a viable generation source. Both the UK and Poland are expected to make announcements regarding new-build projects. The key obstacle for developers in this area will be the issue of how to protect developers from the massive risks, including environmental risk and the risk of regulatory change, presented by the generation of nuclear waste, both in terms of quantum and in terms of time-scale.

US Energy Industry in 2006

Of course, energy is a truly global sector and parallel developments can be expected in other major and emerging markets. Across the Atlantic activity in the US energy industry in 2006 is likely to be driven by three main factors: the passage of the Energy Policy Act of 2005, which creates many new incentives and authorities; the belief that mandatory limits on CO_2 emissions are just around the corner; and the price shocks of 2005.

Climate change considerations, state mandates (some as high as 20%) and EPAct's short extension of the highly favourable production tax credit will keep the renewable energy market hot. No longer is wind the only player. Solar and biomass are also beginning to get serious attention.

The paired expectations that CO_2 limits are coming and that there will always be a need for large base load power plants make new nuclear plants a real option for the first time in almost 30 years. The preliminary announcements many utilities made in 2005, of their intention to build new nuclear plants, will have to evolve into serious pre-construction activity in order to put plants among the handful that will qualify for new federal loan guarantees and regulatory risk insurance. (IGCC coal plants will be competing for the same loan guarantees).

EPAct 2005 weakened the ability of states to delay infrastructure projects, including both LNG facilities and electric transmission facilities. Federal regulators have also been directed to create incentivised rates for new transmission. This should mean new life for projects that have been languishing.

Since the 1930's, US law has sharply constrained utility mergers. Those restrictions have been lifted, and the federal review process has been streamlined. That may give rise to previously barred combinations. The unknown, however, is what role state regulators will play. If merger efficiencies are reduced and unbundled utilities are unable to assure low rates for consumers, state regulators may impose unpalatable or even intolerable conditions. The jury is out on that question, and the answer may vary from state to state.

Asia: Focus on China

China has recently restructured its energy-related agencies following widespread criticism of the Energy Bureau's management of China's energy resources. In May 2005, the Chinese government formed a new interagency task force under the leadership of Premier Wen Jiabao to better regulate China's energy industry. The task force is responsible for strategic planning and making policy suggestions to the State Council.

The newly established vice-ministerial-level State Energy Office ("SEO") is responsible for managing the task forces' daily affairs, such as overseeing energy security and aiding the task force in its decision-making. It is hoped that the SEO will have more influence than other regulatory agencies because it reports directly to the State Council. The SEO's mandate is likely to extend to procuring foreign gas and oil, managing domestic coal supplies, settling power shortages, enforcing industrial energy efficiency and reducing pollution.

The Chinese government is anxious to promote renewable energy production to meet rising energy demand, help protect the environment, and reduce dependence on imported energy. To that end, China's Renewable Energy Law was issued on 28 February, 2005 and will take effect on 1 January, 2006. It is hoped that the implementation of this law will help increase the country's renewable energy consumption to 10% by the year 2020.

Additionally officials from the National Development and Reform Commission ("NDRC") have reported that China will soon start drafting a new energy law and an oil and gas development law and also amend the Electric Power Law. In addition, the China Coal Information Institute is currently drafting an amendment to the Coal Law.

A key feature going forward is that the NDRC and the Ministry of Finance are considering deregulating energy prices due to China's growing energy crisis which could radically alter the structure of the Chinese energy market.

Authors:

Thierry Chaumeil, Paris; Tomasz Dobrowolski, Warsaw; Joseph Phelan, London; Steven Robinson, Shanghai, Beijing and Hong Kong; and Mary Anne Sullivan, Washington DC. Each are energy lawyers at law firm Hogan & Hartson.

mergermarket. Part of The Mergermarket Group

91 Brick Lane
London E1 6QL
United Kingdom

t: +44 (0)20 7059 6100
f: +44 (0)20 7059 6101
sales@mergermarket.com
crm@mergermarket.com

3 East 28th Street
4th Floor
New York
NY 10016, USA

t: +1 212 686-5606
f: +1 212 686-2664
sales.us@mergermarket.com