

Gas Regulation

In 30 jurisdictions worldwide

Contributing editors

David Tennant and Torquil Law



2015

GETTING THE
DEAL THROUGH 

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DEAL THROUGH 

Gas Regulation 2015

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CONTENTS

Global Overview	5	Kazakhstan	100
David Tennant and Torquil Law Dentons UKMEA LLP		Umid Aripdjanov and Assel Meiramgaliyeva Colibri Law Firm	
Albania	7	Malaysia	106
Renata Leka and Besa Velaj (Tauzi) Boga & Associates		Mohamed Ridza Abdullah Mohamed Ridza & Co	
Angola	12	Mexico	114
Helena Prata and Sofia Cerqueira Serra Angola Legal Circle Advogados and Morais Leitão, Galvão Teles, Soares da Silva & Associados		Rogelio López-Velarde and Amanda Valdez López Velarde, Heftye y Soria SC	
Austria	19	Mozambique	121
Thomas Starlinger Fiebinger Polak Leon Rechtsanwälte GmbH		Hélder Paulo Frechaut AVM Advogados	
Brazil	25	Myanmar	126
Giovani Loss and Felipe Feres Mattos Filho, Veiga Filho, Marrey Jr e Quiroga Advogados		Albert T Chandler Myanmar Legal Services Limited	
Chile	33	Nigeria	130
Felipe Bahamondez Bahamondez, Alvarez & Zegers		Olusina Sipasi and Elu Mbakwe ÆLEX	
Colombia	41	Norway	135
Alvaro J Rodriguez Posse Herrera Ruiz		Yngve Bustnesli Kvale Advokatfirma DA	
Croatia	46	Poland	141
Miran Maćešić and Ivana Manovelo Law Offices Maćešić & Partners		Piotr Spaczyński and Anna Piotrowska Spaczyński, Szczepaniak i Wspólnicy SKA	
Denmark	52	Portugal	150
Per Hemmer, Johan Weihe and Rania Kassis Bech-Bruun		Mónica Carneiro Pacheco and Marisa Apolinário CMS Rui Pena & Arnaut	
European Union	58	Sweden	155
Christian Filippitsch, Maria de Lasala Lobera and Max Seuster Norton Rose Fulbright		Torbjörn Claeson and Torbern Werner von lode advokat	
Faroe Islands	66	Thailand	160
Per Hemmer, Johan Weihe and Rania Kassis Bech-Bruun		Albert T Chandler Chandler & Thong-ek Law Offices Limited	
Ghana	71	Turkey	165
Emmanuel Sekor and Winifred Odoi-Quarshie REM Law Consultancy		Şafak Herdem Herdem Attorneys at Law	
Greenland	76	United Kingdom	170
Per Hemmer, Johan Weihe and Rania Kassis Bech-Bruun		David Tennant, Sam Boileau, Rebecca Owen-Howes and Torquil Law Dentons UKMEA LLP	
Hungary	82	United States	183
Eszter Zádori, Dániel Arányi and Eszter Katona Weil, Gotshal & Manges LLP		Jennifer Morrissey, Jessica Lynch and David Shaffer Dentons US LLP	
Ireland	89	Uzbekistan	191
Alex McLean, Patrick McGovern and Nicole Ridge Arthur Cox		Umid Aripdjanov and Ravshan Adilov Colibri Law Firm	
Italy	95		
Pietro Cavasola and Matteo Ciminelli CMS Adonnino Ascoli & Cavasola Scamoni			

Preface

Gas Regulation 2015

Thirteenth edition

Getting the Deal Through is delighted to publish the thirteenth edition of *Gas Regulation*, which is available in print, as an e-book, via the GTDT iPad app, and online at www.gettingthedealthrough.com.

Getting the Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique **Getting the Deal Through** format, the same key questions are answered by leading practitioners in each of the 30 jurisdictions featured. Our coverage this year includes new chapters on Hungary and Sweden.

Getting the Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.gettingthedealthrough.com.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Getting the Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to David Tennant and Torquil Law of Dentons UKMEA LLP, the contributing editors, for their continued assistance with this volume.

GETTING THE 
DEAL THROUGH 

London
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Chile

Felipe Bahamondez

Bahamondez, Alvarez & Zegers

Description of domestic sector

- 1 Describe the domestic natural gas sector, including the natural gas production, liquefied natural gas (LNG) storage, pipeline transportation, distribution, commodity sales and trading segments and retail sales and usage.

The intensive use of natural gas in Chile is a recent development with a complex commercial history. The introduction of natural gas for industrial and residential use only dates back to 1997, when a transportation pipeline, Gasoducto GasAndes, was inaugurated, bringing gas from the Neuquén Basin in Argentina to the central zone of Chile. In 2004, after natural gas became a key part of the Chilean energy matrix (27 per cent), a new era of tensions started when Argentina imposed export restrictions on the gas coming into Chile. Finally, a third period of natural gas's history began with the inauguration of LNG terminals, now supplying central and northern parts of Chile. The LNG plants have demonstrated that they are a more secure and reliable source of natural gas, and have consistently increased the share of gas in the national energy matrix, coming close to what gas from Argentina represented years ago. Chile has limited conventional energy resources and is highly dependent on the import of energy resources: more than 95 per cent of its oil and natural gas comes from foreign sources. A summary of the main business areas in the natural gas sector is as follows:

Gas exploration and production

Domestic gas exploration and production is very limited. It is located in the extreme south of Chile, at the Magallanes Basin, where the state-owned company ENAP has developed the exploration and production business over many years. Production in that area is at serious risk, because no relevant new fields have been developed that can maintain the current levels of production. Exploration and production have been fostered by the government, and the Magallanes Basin remains the only natural gas production site in Chile. In 2011, ENAP launched an international bid for exploration and production in the Magallanes zone, including exploration for shale and tight gas. In 2014, ENAP announced positive results in its unconventional fields in the Magallanes zone and started operation on a relatively small scale.

Gas transportation

The transportation business has been developed in several zones in Chile, either because of local production, as in the case of the Magallanes zone, or because the natural gas has been imported by international pipelines, or more recently by LNG terminals:

Magallanes zone

The Magallanes zone, in which a pipeline system is associated with ENAP's supplies and the industrial and residential needs of that area, mainly around the city of Punta Arenas. In addition, following interconnection agreements with Argentina in the mid-1990s, additional infrastructure was built, namely the Bandurrias pipeline serving a big methanol development in the area. In addition, in 1999, an extension of Posesión-Cabo Negro pipeline was built, and two new interconnections with Argentina in the continental area of the Magallanes Strait were made. Finally, in 2008, the Pecket-Esperanza pipeline started operations, with a 120km extension serving the city of Puerto Natales.

Extreme north

Two international pipelines (Gasoducto GasAtacama and Gasoducto Norandino) have been developed here by private investors; both started operations in 1999, bringing natural gas from Argentina to supply relevant mining projects, power plants and residential customers around the city of Antofagasta. In 2000, the new local Tal-Tal pipeline associated with Gasoducto GasAtacama was launched to supply power plants in the area. With the gas export restrictions imposed by Argentina since 2004, both main pipelines faced serious economic distress, which also represented a problem for the electricity system of the north due to the lack of power generation. This situation has changed in light of the LNG Mejillones terminal, which provides a new, reliable source of natural gas to the area.

Central zone

The biggest population and industrial developments are located in the central zone. Natural gas imports started in 1997 with the Gasoducto GasAndes pipeline, a private investor initiative that was feasible based on supplying Metrogas, a big distribution company serving the city of Santiago, and three power plants in the same area. In 1998, gas was transported to the Valparaíso Region by the new Gasoducto Electrogas pipeline, mainly to the city of Valparaíso. The restrictions imposed by Argentina since 2004 also caused major distress for these projects, putting them in serious financial difficulties. The operation of the LNG Quintero terminal has changed, making the central zone almost fully independent from Argentinean natural gas.

Southern Chile

Developed by private investors, the Gasoducto del Pacífico international pipeline started operations in 1999. It brings natural gas from Neuquén Basin in Argentina and supplies the industrial and residential needs of the Concepción and Talcahuano areas. It supplies Innergy, the main industrial natural gas distributor, and Gas Sur, the main residential natural gas distributor of the area.

Considering the above, the gas transportation infrastructure in Chile is basically formed by Enap Magallanes, Gasoducto GasAndes, Gasoducto Electrogas, Gasoducto del Pacífico, Innergy Transportes, Gasoducto GasAtacama, Gasoducto Norandino and Gasoducto Tal-Tal. Perhaps the most relevant feature of this infrastructure is that there is no physical interconnection between the different zones. Therefore, instead of one system, there are several subsystems that operate independently. This may change with the development of the LNG terminals.

LNG terminals

The LNG terminals are probably the most relevant development in the local natural gas sector. Chile currently has two LNG terminals: LNG Mejillones and LNG Quintero. They were developed in response to the restrictions of natural gas from Argentina and as a way to provide a more reliable source of natural gas. This has proved to be a key economic decision by the government of that time, which strongly backed the involvement of ENAP in the project. The LNG business has very strong prospects in Chile, bearing in mind the development of shale gas in developed markets and Chile's need to increase its energy supply. New actors (namely, the Bío Bío Generación Project in southern Chile, previously known as the Octopus Project) announced that the environmental review process has started for an LNG project and two combined cycle power plants in the

Concepción-Talcahuano area. This project is potentially the most relevant one related to natural gas in Chile and involves relevant actors such as American Cheniere Energy, French EDF and local investors.

GNL Quintero

Located in Quintero Bay in the central zone of Chile, and in operation since the end of 2009, GNL Quintero is a terminal for the reception, storage and regasification of LNG. It supplies Santiago and the central zone. The LNG comes from British Gas, which was also a partner in the project. The LNG plant was built on a 40-hectare site and is formed of:

- a 1,878m-long dock 12m above the ocean that accommodates the arrival of LNG vessels and transports the element to the storage facilities;
- three storage tanks – the first has a capacity of 14,000m³ and has been in operation since June 2009. The second and third each have a capacity of 160,000m³. The LNG is transported from these tanks to the regasification plant to obtain natural gas;
- a regasification plant with three vaporisers that process 2.5 million tons of LNG per year, producing 10 million m³ of gas per day as a base and up to 15 million m³ per day in peak times, which are injected into central Chile's pipeline system. The design of the plant allows up to 20 million m³ per day; and
- a patio for loading trucks, which started operating in mid-2011, carrying the available capacity to supply the natural gas needs of ENAP's refinery in Talcahuano, southern Chile. The trucks carry the LNG to a small regasification plant near the city of Concepción, and the natural gas is later transported by the existing infrastructure (Gasoducto del Pacífico and Innergy) to ENAP's plant. The plant is currently operating at a level of 300,000m³ per day, but it was designed for twice as much. It is expected that any excess will supply industrial and residential needs in the Concepción area. This was an interesting development as it virtually interconnects two different zones, the central and southern systems, not by physical infrastructure but through a 20 to 30 truck fleet providing an equivalent function. ENAP has indicated its willingness to replicate the model for Temuco city further south, where cleaner sources of energy are urgently needed. In addition, Metrogas, a partner in GNL Quintero, also has a project to bring LNG to Concepción by building a similar plant that will boost the business of its related company, Gas Sur.

Recently, GasValpo, a distributor of natural gas in the Valparaíso area, has announced its plan to build regasification plants and have a truck fleet to serve cities up in north such as Coquimbo and La Serena and also cities beyond Santiago not currently served in the central zone of Chile such as Los Andes and Talca. This will be in direct competition to the expansions plans of Metrogas to cover these markets.

GNL Mejillones

In operation since early 2010, GNL Mejillones consists of a reception and regasification terminal built in Mejillones Bay in northern Chile, near Antofagasta. It has a dock for LNG vessels coming from different suppliers. The LNG is initially stored in a floating storage unit, after which it goes through regasification and is transported by an 8km pipeline. The construction of a second phase is underway by the investors leading the project, under the supervision of GDF Suez, with a land storage facility in place of a floating one. GNL Mejillones is providing regasification and storage services to any potential interested party under the open access rules.

Natural gas distribution

There are at least seven companies currently conducting natural gas distribution. The most relevant is Metrogas, the industrial and residential distributor in Santiago that started operations with the arrival of natural gas in Santiago from Argentina through Gasoducto GasAndes in 1997. It has approximately 500,000 customers. In Valparaíso, the distributor is GasValpo. In the south, Innergy handles industrial distribution, while residential distribution is the responsibility of GasSur and Intergas. In the extreme south, industrial and residential distribution is conducted by Gasco Magallanes. In the north, Distrinor is the distributor in Antofagasta city and Lipigas is the distributor in Calama city.

Gas trading

This is not a well-developed area of business in Chile, and there only a few trading companies: Distrinor in Antofagasta, Innergy Soluciones Energéticas in Concepción and Progas in Santiago.

2 What percentage of the country's energy needs is met directly or indirectly with natural gas and LNG? What percentage of the country's natural gas needs is met through domestic production and imported production?

The country's energy needs have traditionally been linked to five major energy sources: oil, coal, natural gas, hydroelectricity and wood (the proportion of each varies with time). Chile has limited conventional energy sources, and is highly dependent on external sources such as oil and natural gas.

Until the 1990s, natural gas represented less than 10 per cent of the energy matrix. In 1997, this changed with the start of natural gas imports from Argentina. In 1998, natural gas represented 15 per cent of the energy matrix, in part substituting oil imports. Natural gas's peak was 2004 when it represented 29 per cent of the energy matrix but that year Argentina started supply restrictions. By 2007, the natural gas share decreased to 16.5 per cent, and to 10 per cent in 2008.

The recent launch of the LNG terminals broke this trend, renewing the participation of natural gas in electricity generation, and in 2014 it represented nearly 18 per cent in the whole energy matrix. The expectation is that LNG will continue to play a very significant role in the energy matrix, both in the SIC central interconnected system and the the Norte Grande Interconnected System, and in the industrial and residential consumption of natural gas.

Government policy

3 What is the government's policy for the domestic natural gas sector and which bodies set it?

The natural gas business in Chile did not evolve from the privatisation of state-owned companies, as was the case for the electricity sector in the mid-1980s, which also had a high degree of government regulation. The natural gas sector is different because, aside from the Magallanes zone, it was developed by private investors who took the business risk. That may help to explain why this is essentially a non-regulated sector, both in terms of structure and pricing.

When introducing natural gas in central Chile in the mid-1990s, the government studied different regulatory alternatives but decided to follow a free market approach in which the degree of public intervention was the lowest possible. With regard to the legal framework of the natural gas sector, the most relevant legislation is:

- the Gas Law (DFL No. 323 of 1931 and further amendments);
- the Regulation on Provisional and Definitive Concessions for the Distribution and Transportation of Gas (DS No. 263 (Ministry of Economy) 1995);
- the Regulation of Gas Services (DS No. 67 (Ministry of Economy) 2004);
- the Regulation on Security for Transportation and Distribution of Gas (DS No. 280 (Ministry of Economy) 2009); and
- the Regulation on Security for LNG Plants (DS No. 277 (Ministry of Economy) 2007).

The natural gas interconnection with Argentina was based on the Substitutive Protocol of Protocol No. 2 of the Agreement for Economic Complementarity of 1995 between Chile and Argentina. This was a success for a few years, but it led to the gas crisis with Argentina that began in 2004 and ended with the development of LNG terminals to end Chile's dependence on Argentinian gas.

Since Chile does not have relevant sources of natural gas, the regulation of conventional and unconventional sources is not of importance for the time being. If unconventional sources in the Magallanes zone develop well in the future, a more detailed regulation will be probably required.

Regarding the institutional framework, the competent agencies are the following.

Ministry of Energy (the ME)

The ME has been in operation since early 2010 in accordance with Law No. 20,402. Before its creation, its powers were exercised by the Ministry of Economy and the Ministry of Mining. The ME develops and coordinates

the plans, policies and norms for the proper performance of the energy sector, supervises its performance and advises the government in all matters related to energy. In addition, the ME coordinates the different entities related to energy in Chile, including those in connection with natural gas. The head of the ME is the Minister of Energy, appointed by the President. The Minister's main duty is to develop long-term policies for the energy markets in Chile. In 2012, the ME launched Chile's strategic long-term energy plan, which will have to deal with legal and technical proposals to meet the energy needs of the country within a 30-year time frame.

National Commission of Energy (the CNE)

The CNE is a public and independent agency, with its own resources and full powers that relate to the President by means of the Ministry of Energy. According to its Organic Law (DL No. 2,224 of 1978 and further amendments), it is a technical entity in charge of the analysis of prices, tariffs and technical rules for companies dealing with the production, generation, transportation and distribution of energy with the purpose of having the most secure, reliable and efficient energy system.

Superintendence of Electricity and Fuels (the SEC)

In accordance with its Organic Laws (Law No. 18,410 and Law No. 19,613), the SEC supervises the proper operation of electricity, gas and fuel facilities in terms of security, quality and pricing. The SEC is in charge of compliance for all regulatory norms on generation, production, storage, transportation and distribution of all fuels, gas and electricity. It also grants concessions, including gas concessions to interested parties. The SEC has the authority to impose fines and, if necessary, to take over the administration of deficient services at the expense of the concessionaire. In general, the ME and the CNE determine the regulatory policies of the natural gas sector, while the SEC is in charge of the supervision of and compliance with the regulations.

Regulation of natural gas production

4 What is the ownership and organisational structure for production of natural gas (other than LNG)? How does the government derive value from natural gas production?

The Magallanes zone is the only area in Chile supplied by local production. Its development is led by ENAP. The Magallanes Basin is in the same area as Argentina's Austral Basin, and is the only area in Chile where the production of natural gas has been commercially feasible. It has an important pipeline system of approximately 500km connecting the fields with the main consumption areas. The Magallanes zone was the first area to develop natural gas, with the help of the public sector through ENAP. Distribution prices are regulated in Magallanes only, with no restrictions in the rest of the country. The government derives value from exploration and production mainly by the subscription of special contracts of operation (CEOPs) executed between the investor (local or foreign) and the state to carry out exploration and production in specific gas fields. CEOPs do not affect state ownership of the fields, and they are not concessions, but grant certain relevant rights and benefits for both parties. The investor gets retribution in money or in kind (hydrocarbons), subject to taxes (maximum rate of 50 per cent), and may, with prior authorisation, export the hydrocarbon it has received. There are no special rules for exports, with relevant exceptions for foreign exchange. Alternatively, only the state may acquire the hydrocarbon at its discretion. After an international bid in September 2011, ENAP, along with Geoprak, YPF and Wintershall, presented a CEOPs request to the ME concerning five exploration blocks in the Magallanes zone: Isla Norte, Campanario, Flamenco, San Sebastián and Marazzi-Lago Mercedes. Production is under serious threat because of a lack of new fields, and experts have predicted that by 2014, it may be unable to satisfy either the industrial and residential consumption in the Magallanes zone.

5 Describe the statutory and regulatory framework and any relevant authorisations applicable to natural gas exploration and production.

The Constitution indicates that the state has absolute ownership of hydrocarbon deposits, and also prescribes that exploration and exploitation can be carried out by the state or its companies directly or by means of administrative concessions or by CEOPs (article 19 No. 24 of the Constitution). CEOPs are the standard way in which private companies, either local or foreign, may participate in exploration and production (the first CEOP dates back to 1977). CEOPs are regulated by DFL No. 2 (Ministry of

Mining), which sets the text of DL No. 1,089 of 1975. Another relevant statute in exploration and production is the ENAP's Organic Law (Law No. 9,618 of 1950), which grants certain prerogatives to ENAP related to exploration and production directly, or through other companies in which it may participate or in association with third parties, by administrative concessions or by CEOPs.

New hopes are being placed on unconventional resources, namely shale gas, which according to the initial assessment of international agencies is present in the area, but which up to now has seemed scarce and expensive to exploit. For the time being, however, there are no relevant differences between the regulation of conventional and unconventional sectors.

6 Are participants required to provide security or any guarantees to be issued with a licence to explore for or to store gas?

As explained before, the business of gas exploration is carried out by means of administrative concessions or by CEOPs and the participants are normally required to provide security or guarantees to develop the activity. The business of gas storage is not regulated in Chile and companies provide gas storage based on private commercial arrangements (normally called gas parking agreements) that may eventually contemplate the need to provide guarantees. The gas storage business is an area that would probably require a more detailed regulation in the near future considering that the natural gas business has witnessed considerable development since its early years.

Regulation of natural gas pipeline transportation and storage

7 Describe in general the ownership of natural gas pipeline transportation, and storage infrastructure.

With the exception of the Magallanes zone, where it was developed with strong public participation led by ENAP, the natural gas transportation business is a relatively recent development in Chile. Gas transportation pipelines in the central and northern zones need to import natural gas for power generation and a clean energy source for industrial or residential use (by importing natural gas from Argentina in the past; currently from LNG). They are all private initiatives, except for the minority stake (of around 20 per cent) ENAP has in Gasoducto del Pacifico and Innergy.

Natural gas use is divided into four areas or zones: North (Region II), Central (Region V and Santiago/Metropolitana), South (Region VIII) and Magallanes (Region XII). There is no interconnection between them. In the north, the two pipelines serving the area are not interconnected. The pipelines in Magallanes are the only ones transporting Chilean production of natural gas.

The lack of interconnection between the zones affects direct competition in the natural gas market to a certain degree, in terms of negotiations with gas producers and also regarding potential secondary markets. There is no possibility to exchange available capacity or excess production. In each zone, the natural gas transportation facilities are technically natural monopolies. Another important factor is the degree of vertical integration present among transportation facilities, distributors and large customers.

Notwithstanding the above, it is not possible to conclude a discriminatory or abusive conduct suit based on this vertical integration; to date, neither type of suit has been discussed before the antitrust courts.

8 Describe the statutory and regulatory framework and any relevant authorisations applicable to the construction, ownership, operation and interconnection of natural gas transportation pipelines, and storage.

The most relevant law regulating the natural gas sector (the Gas Law) was enacted in 1931. During the 1990s, the obsolete regulatory framework was insufficient to deal with the new projects under construction regarding the interconnection with Argentina. Considering the time needed for a change to the law, the government decided to push forward, using administrative regulations for the most urgent issues surrounding fostering the new projects. It was in this spirit that the Regulation on Definitive and Temporary Transportation and Distribution Gas Concessions (DS No. 263 of 1995) was enacted. It stipulates that companies interested in the gas transportation business must have a definitive concession that allows them to provide such service and build, maintain and exploit the gas transportation system. This Regulation also sets the requirements for the awarding of transportation concessions, either temporary or permanent based on the construction

status of the project. Temporary concessions allow the concessionaire to perform base line studies and preliminary works. Permanent concessions allow the concessionaire to build and operate a facility and also grant the right to impose easements over the land along the pipeline.

Definitive concessions are granted by the President for an indefinite period of time. A prior favourable report from the SEC is required. The company must also present legal, technical and economic data from the project. It is permitted by law to have more than one pipeline in the same zone, as is the case in northern Chile. The authorities cannot deny a concession if the company complies with all the requirements indicated by the Regulation. The Gas Law also indicates that these activities shall not constitute a monopoly; therefore, the concession does not grant exclusive rights.

Transportation is subject to open access rules, understood as the public offer made by the gas transportation company of its services on equal economic, commercial and technical conditions regarding its available transportation capacity. Even if there is a natural monopoly, legal prescriptions prohibit an abuse of dominant position or discrimination among potential customers for its services. The gas transportation business must also comply with the Regulation of Security for Transportation and Distribution of Gas, in relation to the design, construction, operation, maintenance, repairs, amendments, inspection and termination of operations of a natural gas pipeline.

In addition, the construction of a natural gas transportation system requires an environmental impact assessment approval, which involves several administrative approvals in a complex process, and which includes local community participation. Other administrative permits may be required, such as construction approvals and permits from the competent municipalities.

9 How does a company obtain the land rights to construct a natural gas transportation or storage facility?

Gas transportation concessions, according to the Gas Law, grant the concessionaire the right to use all public property, including roads, rivers and water channels, and also the right to impose easements over private properties, to secure the construction of the pipeline and related facilities. These easements will be granted in accordance with the information provided in the concession decree. Proceedings to impose the easements must start within six months from the concession being granted. After that term, the concessionaire may lose the right to impose them.

Under the Gas Law, there is also the possibility of summary proceedings to impose easements in the event of opposition from landowners. Landowners have the right to be compensated for all damages caused by the easements within the parameters indicated by law. In addition, it is always possible to negotiate voluntary easements, thereby saving time and costs. In any event, to be opposable to third parties, the easements must be executed by notarised public deed and registered in front of the competent real estate registry.

10 How is access to the natural gas transportation system and storage facilities arranged? How are tolls and tariffs established?

As described above, gas transportation is subject to open access rules, defined in Regulation DS No. 263, which seek to soften natural monopolies and avoid potential discrimination. Open access rules have operated in practice through public calls to engage the available capacity for pipeline transportation by means of public bids. In terms of price, the existing natural gas regulation for transportation services allows free determination, with the only requirement being not to discriminate among clients with similar characteristics and consumption, which complements the open access rules.

Freedom of price has been sustained by certain strategies such as the introduction of natural gas substitutes into the market at competitive prices and the overall efficiency of the transportation system, in order to compete with alternative fuels. Some of these ideas were subject to academic discussion in the past, but the original model for natural gas in Chile still remains as it was conceived in the mid-1990s. Some update of the legislation is probably required, particularly bearing in mind the increasingly important role of the LNG industry.

11 Can customers, other natural gas suppliers or an authority require a pipeline or storage facilities owner or operator to expand its facilities to accommodate new customers? If so, who bears the costs of interconnection or expansion?

The open access rules only refer to available capacity in relation to the gas transportation concessionaire. Therefore, theoretically, any expansion beyond the available transportation capacity should be subject to contractual arrangements with the interested customers. In practice, transportation companies normally consider potential new business to finance the expansion (at least in part). On the other hand, wholesale customers have the alternative of a physical bypass, in which they carry their own gas to their industrial facilities and interconnect to a gas transportation grid, which is possible under the open access rules.

12 Describe any statutory and regulatory requirements applicable to the processing of natural gas to extract liquids and to prepare it for pipeline transportation.

In recent years, the regulatory requirements applicable to the processing of natural gas to extract liquids and prepare it for pipeline transportation have been subject to the applicable norms of Argentina, from where it came. Notwithstanding that, gas transportation agreements (GTAs) have stated quality specifications, such as heating values and impurities. For example, a typical clause should indicate the minimum and higher heating value of the gas to be received and delivered by the transporter (8,850Kcal/m³) or the maximum higher value (10,200Kcal/m³). Regarding impurities, a standard threshold should be gas delivered by the transporter free from sand, dust, gums, oils, liquefiable hydrocarbons and at temperatures in excess of -4°C at 5,500kPa. Any other objectionable substances that may become separated from the gas, and other solids or liquids, which may render it non-commercial, or cause injury to or interference with the proper operation of the pipeline, shall be forbidden.

It is also standard that GTAs contain detailed specifications regarding the content of different substances, such as hydrogen sulphide, carbon dioxide and water. In summary, natural gas supplied in Chile must fulfil the technical rules and specific thresholds contemplated in Regulation DS No. 132 of 1979 (Ministry of Mining), including quality rules applicable to oil, its derivatives and other fuels, and must also comply with Chilean Official Norm NCH2264 of 1999 Regulation DS No. 361 of 1999 (Ministry of Economy) on Specifications of Natural Gas.

13 Describe the contractual regime for transportation and storage.

The natural gas market is not highly regulated, and there is mostly full freedom of contract for any participants in the transportation and storage of natural gas. Concessionaires are free to sign private GTAs with any gas distributors or wholesale consumers, while distribution companies are free to contract with industrial developers and commercial or residential customers. The SEC does not have direct access to the details of these contracts, which access would be an incentive to mitigate any potential discrimination among customers. Ordinarily, distribution companies and wholesale customers have supply agreements with the gas producers directly and a GTA for determined capacity with the corresponding gas transportation company.

In general, it is common practice to reserve a certain amount of capacity that must be available at all times when transportation is needed. The client must pay for that capacity, even if he or she does not use it. There are firm obligations during the life of the contract that the transporter must have the capacity available at all times, and the client must pay for that capacity regardless of whether it is used (take or pay). During the Argentine gas crisis, these take or pay obligations became a significant burden for Chilean clients, with the payment obligation remaining notwithstanding the lack of gas.

The transportation price is normally related to this reserved capacity, with a fixed charge per cubic metre of gas multiplied by the maximum daily quantity multiplied by the number of days of the pertinent month. Since the gas crisis with Argentina, the situation has changed and, after a long period of negotiations, in some cases with litigation, GTAs are now taking the uncertainty of gas supply from Argentina into account. GTAs have also extended the concept of force majeure, and have basically only created obligations where there is available gas to transport.

Regulation of natural gas distribution

14 Describe in general the ownership of natural gas distribution networks.

The natural gas distribution networks are located in the same areas as transportation systems, normally around populated cities and industrial complexes. They are privately owned and almost fully integrated into the transportation grid. The Gasoducto GasAndes, which transports natural gas to Metrogas (the main gas distributor in Santiago), is privately owned and controlled by Gasco. Gasoducto GasAndes also supplies GasValpo, a distribution company in the Valparaíso area.

In the north, the distribution company for Antofagasta is Distrinor, which has residential and industrial clients. In Calama, Lipigas distributes natural gas. In the south, Gasoducto del Pacífico transports natural gas for Innergy, privately owned by different entities including ENAP; Innergy is the main industrial distribution company in that area. The residential segment in Concepción is provided by GasSur, which is now fully owned by Gasco. There is also a competitor for the residential and commercial segment in this area, Intergas, which is privately owned.

Finally, in Magallanes, the distribution is carried out by the privately owned Gasco Magallanes. Again, as in the transportation business, there is no interconnection between zones, and each system works independently. This situation, and the Argentina gas crisis, forced the participants in this market to invest in LNG supply to ensure a more reliable source of stock.

15 Describe the statutory and regulatory structure and authorisations required to operate a distribution network. To what extent are gas distribution utilities subject to public service obligations?

According to the Gas Law, permanent concessions are required for the natural gas distribution business. The distribution business is a public service, and it is possible that two concessions coexist in the same area. However, the regulation grants the right to the incumbent to expand its prior concession, granting him or her a second one. Regulation DS No. 263 states that two different distribution concessions may coexist in the same geographical area. The same Regulation prescribes the requirements to request a distribution concession, which may be temporary or permanent (see question 8).

The gas distribution business must also comply with the Regulation of Security for Transportation and Distribution of Gas, DS No. 280. Finally, the construction of the distribution system requires environmental impact assessment approval, construction approval and permits from the competent municipalities (see question 8).

16 How is access to the natural gas distribution grid organised? Describe any regulation of the prices for distribution services. In which circumstances can a rate or term of service be changed?

The principle is that distribution companies are obliged to supply gas subject to its available capacity and the security of its facilities. Generally, distribution is not separated from trading, and distribution concessionaires are not subject to open access rules.

According to the law, they are free to determine prices, and are not allowed to discriminate between customers with similar characteristics and consumption. The Gas Law also demands that concessionaires shall publish the tariffs for different kinds of customer, especially residential clients and industrial facilities with relatively low consumption. The government, by request of the Antitrust Court (the TDLC), has the right to determine the tariffs for distribution companies in zones where each client, individually, has a consumption below 100Gj per month and the distribution concessionaire gets, from the existing tariff system, an economic rate of return 5 per cent greater than the rate of the annual cost of capital defined in the norms. During 2014, the government announced a bill of law to regulate the tariffs for distribution of natural gas based on their own studies that demonstrate that distribution companies, particularly Metrogas in the Santiago area, have exceeded the permitted rate of return. For its part, Metrogas contested the studies and the matter is being currently discussed at the TDLC. It is likely that the government will insist in pushing forward the bill of law on distribution tariffs.

The prices of the distribution company Gasco Magallanes, in the extreme south, are regulated in recognition of the fact that there are no fuel alternatives in that area. In the rest of the country, distribution prices are not regulated, making Chile a very unusual case of free markets, both in structure and in prices.

17 May the regulator require a distributor to expand its system to accommodate new customers? May the regulator require the distributor to limit service to existing customers so that new customers can be served?

Distribution concessionaires are obliged to provide a service to any customers within their zone of concession, in accordance with the availability and security of their facilities. In exceptional circumstances, and unless the parties are in agreement about extensions or improvements to the distribution network, the SEC may order the expansion of the low pressure grid, at its cost, even outside the zone of the original concession. This could happen if there is a minimum guarantee of annual consumption during the first three years, equivalent to the cost of installations. In these cases, the distribution company may still charge for certain elements of interconnection, even the part not covered by the above consumption guarantee.

18 Describe the contractual regime in relation to natural gas distribution.

The practice has been for distribution companies to buy natural gas directly from producers, normally outside Chile. Generally, they contract firm transportation capacity if appropriate and, in the case of most distribution companies, they have previous obligations to fulfil (mostly as a public service provider). The contractual relationship with gas producers is normally on a firm basis (deliver or pay (DoP)). During the gas crisis with Argentina there was debate, which occasionally went to the courts, about DoP and the force majeure argument to limit the distribution companies' exposure. There are also wholesale customers that contract directly with gas producers, in a sort of commercial bypass, but this dynamic only works if those producers are able to use the distribution network. This point is debatable. The regulation is clear regarding the physical bypass, due to the open access rules; however, the commercial bypass is not as clear, and it appears that it is subject to agreement between the parties.

Prices basically respond to the strategies of companies as they attempt to gain market share. Distribution companies do not use fixed charges until they have a reasonable number of clients with high exit costs. They have also used discounts for volumes, a practice in Chile unrestricted by the antitrust agencies.

Regulation of natural gas sales and trading

19 What is the ownership and organisational structure for the supply and trading of natural gas?

Distribution is not formally separated from trading. However, to be precise, trading companies do not have an obligation to publish their tariffs because they are not public service providers.

Chile is not a significant natural gas producer, so activities such as supply or trading are not properly developed. Distribution companies, power plants and wholesale customers negotiate directly with gas producers and then negotiate transport capacity with existing pipelines.

20 To what extent are natural gas supply and trading activities subject to government oversight?

These activities are not public services per se, and, therefore, are not subject to governmental regulatory oversight. For this reason, they may potentially discriminate among customers with private contracts. Overall, because of the lack of regulation, the existence of a secondary market for excess capacity is rather low. In the south of Chile, there is one company related to Innergy that has played a trading role with some degree of success. A loophole exists in the Gas Law regarding these entities, with a responsibility for the general obligations being the only legal standard applicable, as with any other commercial entity doing business in Chile. Currently, rather than government oversight, supply and trading activities are subject to the supervision of the antitrust agencies, which exercise real oversight of the free market conditions of these activities. The antitrust agencies may act only upon a request from a third party.

21 How are physical and financial trades of natural gas typically completed?

In the natural gas market, wholesale consumers and distribution companies have in the past negotiated directly with gas producers in Argentina, where the price of gas is determined by several mechanisms. There is no public information available about prices for each client contained in private contracts not subject to SEC scrutiny. The exception is the Magallanes

zone, where local natural gas production is decreasing and the tariff is regulated. As a result, residential customers in the Magallanes zone pay around six times less for equivalent consumption compared with residential customers located in Santiago.

22 Must wholesale and retail buyers of natural gas purchase a bundled product from a single provider? If not, describe the range of services and products that customers can procure from competing providers.

Distribution companies and wholesale buyers deal directly with gas producers, and contract transportation services separately. Gas producers in Argentina have been highly concentrated; only a few players appear to be relevant. For instance, at the moment there is no alternative to importing natural gas from Argentina, because this would require an export permit, which that government will not grant. Therefore, this market was not fully competitive in the past, and remains the same due to existing gas export restrictions imposed by Argentina. LNG seems the only viable alternative for local demand. With regard to LNG supply contracts, the supply contract between GNL Quintero and British Gas will remain in place for several more years.

Regulation of LNG

23 What is the ownership and organisational structure for LNG, including liquefaction and export facilities, and receiving and regasification facilities?

Chile's two LNG terminals exist mainly as a response to Argentina's restrictions on gas exports starting in 2004, and are well-developed businesses.

LNG Quintero

This is a private sector project owned by Endesa Chile (20 per cent), Metrogas (20 per cent), ENAP (20 per cent) and the joint companies Enagás-Omán Oil (40 per cent). There has been discussion in Chile about eventual access to the system for potential participants in the market arguing the status of the terminal as an essential facility. The owners argue that it is a private project, with considerable investment, which only foresees business with a potential client if there is gas and capacity available. In 2013, British Gas sold its remaining 20 per cent stake and is now the sole supplier of LNG to the project.

LNG Mejillones

This is also a private sector project, owned by Codelco (37 per cent) and GDF Suez (63 per cent). The company has taken steps to open the terminal to third parties in a kind of voluntary open access regime. It will offer regasification and storage services to any interested party. Clients must find their own LNG supply.

24 Describe the regulatory framework and any relevant authorisations required to build and operate LNG facilities.

The Regulation on Safety for LNG Plants (DS 277 of 2007 (Ministry of Economy)) contains the requisites for design, construction, operation, maintenance and decommissioning of LNG plants. It also includes detailed obligations for the entities involved. The SEC is in charge of supervising compliance of these norms. Regulation DS 277 makes a reference to NFPA 59A-2006 Standard for the Production, Storage and Handling of Liquefied Natural Gas.

Local norms prescribe a requirement for registration of the plant before the SEC, prior to its operation. In addition, the construction of LNG plants requires environmental impact assessment approval, which is a complex process involving the participation of local communities. Other administrative permits are required, such as construction approvals and permits from the competent municipality.

25 Describe any regulation of the prices and terms of service in the LNG sector.

Like the natural gas market, there are no specific rules for pricing, which is subject to negotiation among the parties involved. Notwithstanding this, there is current pressure from customers outside the property of the LNG terminals – mainly power plants – requesting further regulatory involvement regarding prices for the different services rendered by LNG plants. The regulator has publicly indicated that it is currently studying the LNG market and could eventually propose changes to the legal framework, particularly in sensitive areas such as access to facilities and prices.

In any event, the use and commercialisation of LNG in Chile must comply with the technical rules contained in Regulation DS No. 132 of 1979 (Ministry of Mining), including quality rules, applicable to oil and its derivatives and also to other fuels. The Chilean Official Norm NCH2264 of 1999 Regulation DS No. 361 of 1999 (Ministry of Economy) is also applicable.

Mergers and competition

26 Which government body may prevent or punish anti-competitive or manipulative practices in the natural gas sector?

Law Decree No. 211 of 1973 (DL 211) and its amendments set the legal framework for antitrust matters in Chile, including in the gas sector. Such regulation created the TDLC and the national economic prosecutor (the FNE), which are both responsible for enforcing antitrust matters in Chile. The former is an independent court of law, subject to the supervision of the Supreme Court, and its main role is to decide cases that either private individuals or the national economic prosecutor bring before it. The FNE is an independent administrative agency in charge of investigating conduct that may be contrary to DL 211 and represents the public interest before the courts, especially the TDLC.

27 What substantive standards does that government body apply to determine whether conduct is anti-competitive or manipulative?

Article 3 of DL 211 indicates, in a generic form, that anyone that carries out or enters into any conduct, act or agreement that may impede, restrict or obstruct free competition, or that tends to produce said effects, will be sanctioned with the measures contemplated in that statute.

Article 3 further indicates certain events, acts or agreements that are deemed to hamper, restrict or hinder free competition, such as:

- collusion that creates market power by way of express or tacit agreements between competitors to fix sale or purchase prices or other commercial terms, imposing restraints on production, territorial assignment or market quotas, excluding competitors or affecting the result of a bidding process, among other possible cartel conduct;
- abuse of dominant market position by a company or group of companies with a common controlling partner by way of fixing sale or purchase prices, imposing tie-in sales, the assignment of territorial or market quotas, and other similar abuses; and
- predatory conduct or unfair competition leading to attaining, maintaining or increasing a dominant market position. The list of anti-competitive practices is by no means exhaustive, and the TDLC may decide other situations on a case-by-case basis.

28 What authority does the government body have to preclude or remedy anti-competitive or manipulative practices?

The TDLC, in its final judgment, may impose the following sanctions:

- modification or termination of the acts, contract agreements, systems or arrangements held to be contrary to DL 211;
- amendment or dissolution of the partnerships, corporations or other entities involved in the acts, contracts agreements, systems or arrangements held to be contrary to DL 211; and
- imposition of fines for fiscal benefit of up to 20,000 annual tax units (UTA) and, in the case of collusion, up to 30,000 UTA.

The above-mentioned fines may be imposed on both the applicable entity as well as its directors, managers or any person involved in the relevant act. In determining the amount of the fine, the TDLC has to weigh circumstances such as the economic benefit derived from the infringement, the seriousness of the conduct, any recidivist history of the violator and cooperation provided to the FNE before or during the investigation.

Private individuals may bring a civil action for damages in a civil court under a summary proceeding against the offender only after the TDLC has issued a final and binding judgment.

29 Does any government body have authority to approve or disapprove mergers or other changes in control over businesses in the sector or acquisition of production, transportation or distribution assets?

There are no pre-approval requirements for mergers or other changes in control. There is also no legal mandatory requirement to notify the TDLC regarding these matters. However, the parties may voluntarily submit to

the TDLC a request to determine whether the merger (or related transaction), a change of control or the acquisition of assets could be somehow contrary to DL 211. In such case, the decision of the TDLC is binding upon the parties.

In addition, the FNE has put in place a Guide to Horizontal Concentrations (the FNE Concentration Guide), which gives useful parameters to the business community to assess whether the operation would be considered anti-competitive by the FNE.

Other factors will also play a role in the FNE Concentration Guide, including the existence of barriers to entry and sunk costs.

It is interesting to note that the antitrust jurisprudence in Chile shows that market concentration is not considered anti-competitive per se, and it only concerns the antitrust authorities when it may lead to an abuse of dominant position or collusion. Finally, at the request of a third party or the FNE, the TDLC is always entitled to a review of a merger, a change of control or the acquisition of assets, as it is generally vested to resolve any situation that may be considered a violation of DL 211.

In connection with any concession transfer due to a merger or an acquisition of assets, the Gas Law grants a general approval to these transfers, stating that the ownership of the concessions and its transfer shall be registered at the competent real estate registry, and said transfer shall not stop or interfere with the public service obligations and the fulfilment of all the obligations established in the Law. Even if the Gas Law does not say so, it is advisable, in the case of a concession transfer, to make the necessary amendments to the decree granting the same updating information and registration of the same.

30 In the purchase of a regulated gas utility, are there any restrictions on the inclusion of the purchase cost in the price of services?

There are no tariff regulations for gas transportation, distribution or LNG in Chile. The prices of the different services are freely determined by the respective gas company, normally reflected later on in long-term contracts. Therefore, unless the contract provides certain price review, it is unlikely that such purchase cost would be included in the price of services.

The most important deterrent to price determination by gas companies is the restriction of discrimination among customers with similar consumption and, in the case of distribution companies, they must advertise price changes in a newspaper or let the customer know about the changes in monthly invoices prior to the increase. The only regulated service is the distribution of gas in the Magallanes zone, where the Gas Law provides for specific rules to determine the rate of annual capital cost, considering the systemic risk of the activities of the distribution companies with regard to the market, a rate of return free of risk and a premium for market risk. In any event, the rate of annual capital costs in that case shall not be below 6 per cent.

31 Are there any restrictions on the acquisition of shares in gas utilities? Do any corporate governance regulations or rules regarding the transfer of assets apply to gas utilities?

In principle, there are no restrictions on the acquisition of shares in gas utilities, unless the buyer is entitled to a market dominant position that comes to the attention of the antitrust entities. However, market concentration is not considered anti-competitive per se under Chilean antitrust jurisprudence, and it would only concern the antitrust agencies when it may lead to abuse of dominant position or collusion. If the target company trades its shares on the stock market, takeover of that company shall only be made through a tender offer process, regulated in detail in the Chilean Securities Act, unless a legal exemption is available.

Regarding the corporate governance rules applicable to a transfer of assets, sales of 50 per cent or more of the company's assets require prior approval by a shareholders' meeting of the selling company, with the affirmative vote of two-thirds of the issued and outstanding voting shares of the stock.

International

32 Are there any special requirements or limitations on foreign companies acquiring interests in any part of the natural gas sector?

As a rule, there are no special requirements or limitations on foreign companies acquiring interests in the natural gas sector. There is a generic obligation to comply with the laws of Chile and, for instance, foreign

investment and the repatriation of an investment and its profits must be carried out by means of two different legal alternatives, either Chapter XIV of the Compendium of Foreign Exchange Regulations of the Central Bank of Chile or the Foreign Investment Statute (Law Decree No. 600).

The natural gas exploration and production sector is very limited because ownership of these resources belongs to the state under the Constitution, and participation in exploration and production is normally by means of a CEOP that will ensure certain benefits in favour of the government and the investor. In addition, ENAP has important prerogatives in exploration and production in the natural gas sector arising from its Organic Law.

With regard to obtaining a gas transportation or gas distribution concession, the regulations indicate that concessions, either provisional or definitive, may be requested by Chilean citizens or by entities incorporated in accordance with Chilean law, which may have foreign companies as shareholders. The Gas Law also stipulates that, in transfers of a gas concession, if the buyers are not Chilean citizens or Chilean companies organised in accordance with local laws, the buyer must transfer the same within six months to persons or entities that meet this requirement or, alternatively, present the by-laws to the board of a company organised in accordance with Chilean law, and transfer it to that entity within 90 days, including the concession, related assets and rights acquired in accordance with the Gas Law in that transfer. If the terms are not met the government may revoke the concession.

33 To what extent is regulatory policy affected by treaties or other multinational agreements?

The gas interconnection with Argentina, achieved through the Substitutive Protocol of Protocol No. 2 of the Agreement for Economic Complementarity of 1995, was a difficult experience. As previously mentioned, the interconnection worked for several years, but Argentina started to impose gas export restrictions in 2004 and, for several periods, there was almost no gas being supplied to Chile.

At the government level, the preference was to negotiate instead of declaring a commercial war. The results of these negotiations were poor, but at least some residential gas supply was assured. At the company level, some took the litigation alternative, based mainly on DoP arguments, with varying results (most of the cases were settled without final awards). The force majeure argument by gas producers played a key role, and it was well supported by a heavy load of administrative resolutions issued by the Argentine government that put most of them in a situation where it was impossible to honour their contracts.

In practice, Chilean companies opted to devise a new, more reliable and secure alternative, which led to the development of the LNG terminals.

The recent inclusion of Chile as an OECD country has focused the authorities' attention on renewable sources of energy; 20 per cent of the energy on the matrix must come from renewable sources by 2024.

34 What rules apply to cross-border sales or deliveries of natural gas?

Chile does not have rules restricting gas imports. On the other hand, and considering that it is not a relevant gas producer, exports are not a real business, but could be in the future if the LNG plants gain enough gas to export. In the latter case, additional regulation will be required to deal with a situation that could lead to a reverse flow to Argentina, which would be ironic considering past experience.

In any event, the gas now coming from Argentina is subject only to VAT (19 per cent) on the cost-insured freight value of the gas, which must be anticipated by a prior declaration of import (DITA) to be filed at the Customs National Service in Chile (in other words, the tax must be paid prior to the gas entering Chile). The Customs National Service is responsible for controlling and matching what is declared on the DITA with the amount of gas actually imported, backed up by a monthly report filed by transporters.

Transactions between affiliates

35 What restrictions exist on transactions between a natural gas utility and its affiliates?

There are no legal impediments for vertical integration, and the natural gas market in Chile has a relevant degree of integration between transporters, distribution companies and wholesale consumers such as power plants. Regarding the horizontal aspect, the Gas Law indicates that concessions

do not grant monopolies; however, many concessions are in fact natural monopolies. An old ruling from the antitrust authorities at that time, Resolution 933/198 CPC dated 28 April 1995, suggests that certain limitations to the ownership of the gas companies should be implemented to avoid vertical integration. To that effect, it suggested a threshold for stock ownership, so that a gas distribution company, or a power supply company and its related entities, shall not be entitled to own more than 15 per cent of a gas transportation company. It also suggested that, in the case of a distribution company, in the geographical areas in which the distribution company operates, the 15 per cent threshold should also be applied to the ownership of a distribution company by another distribution company, thus avoiding horizontal integration on terms that may be deemed contrary to competition.

Somehow, companies in the gas sector have understood that regulations enacted after the ruling have allowed a more flexible approach to integration and, in the event that anyone wishes to contest the current situation, the TDLC would have jurisdiction.

Regarding agreements with affiliates, corporate governance rules contained in the Corporate Law Act (Law No. 18,046) provide for substantive rules regarding related-party agreements. In summary, these governance rules do not prohibit related-party transactions, provided they are subject to market standards and are duly disclosed at the corporate level.

36 Who enforces the affiliate restrictions and what are the sanctions for non-compliance?

The TDLC would be competent to decide upon any vertical or horizontal integration that a party deems against free competition. To date, even with the degree of integration that is present in the gas sector, no such action has been filed, because it would need to demonstrate a violation of the antitrust standards referred to above.

The FNE may also investigate any proposed transactions to ascertain whether they impair, restrict or eliminate free competition within the relevant market. The economic argument that gas faces fierce competition from alternative fuels has deterred such antitrust actions or investigations to date.

Update and trends

LNG projects are still the most reliable source of natural gas in Chile, which are now reaching a relevant participation in the energy matrix as once did the natural gas coming from Argentina.

New LNG players, such as the Bío-Bío Generación Project, previously known as the Octopus Project, are taking steps to build additional LNG facilities in the south of Chile, including offtakers such as Cheniere Enegy, French EDF and local investors.

Gasoducto del Pacífico and Innergy changed their equity participation in 2014 as a result of TransCanada selling its participation to Gasco and Gasoducto GasAndes changed its equity participation in 2014 as a result of Total selling its participation to Metrogas.

The Spanish Gas Natural Fenosa, by way of the acquisition in 2014 of Compañía General de Electricidad (CGE), has acquired a relevant participation in the natural gas and LNG markets in Chile. In fact, by way of CGE, it now has direct or indirect controlling stakes in Metrogas, Gasco, Gasoducto GasAndes, Gasoducto del Pacífico, Innergy, GasSur, Gasco Magallanes and a non-controlling stake in LNG Quintero. It is likely that the FNE exercises a close supervision and control of these companies' activities due to the high degree of market concentration.

During 2014 the government announced a bill of law to regulate the tariffs for distribution of natural gas based on their own studies that demonstrate that distribution companies have exceeded the permitted rate of return.

In the case of corporate governance rule infringements, civil law actions against directors of companies that did not comply with the rules are available to recover damages caused. In addition, in cases involving public companies, the SEC and the Securities Commission could be potentially competent where regulations under their technical supervision are breached.

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