The Financial Crisis and Implications for U.S.-Mexico Brazil’s New Natural Gas Law

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On March 4, 2009, Brazil enacted a new law (Law No. 11909/09) governing the transportation, storage, liquefaction and commercialization of natural gas. Although the law leaves several implementation details open for development through future rules and actions by the Ministry of Mines and Energy (MME) and the Petroleum and Natural Gas Regulatory Agency (ANP), the law establishes a number of key principles and should bring greater certainty to market participants and greater stability to Brazil’s natural gas markets. The highlights of the new law are described below.

One potential source of controversy is a provision allowing certain types of customers to bypass local distribution companies for their gas supply. The Brazilian Constitution gives the states, rather than the federal government, authority over most issues relating to the distribution of natural gas. It will be interesting to see how this provision is implemented at the federal and state levels and whether its constitutionality is challenged in any way.

Market participants should be aware that the process of developing the implementation rules for the new law is likely to allow for some public input through public consultation mechanisms. In addition to implementation activity at the federal level, through the MME and ANP, we also anticipate that the law will trigger considerable regulatory activity by state regulatory agencies, particularly in São Paulo, Rio de Janeiro, and perhaps other large states. Natural gas market participants should monitor the implementation process and participate to the fullest extent possible.

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Transportation

The law requires that entities engaged in the transportation of natural gas in Brazil be formed under the laws of Brazil and maintain their headquarters and management in Brazil. Entities may engage in transportation activities through authorization or concession. The authorization process applies to pipelines involving international agreements. The concession process applies to all pipelines deemed to be of general interest. Non-Brazilian entities may participate in the concession award process but, if successful, they are required to form a Brazilian entity to engage in the transportation activity. Concessions for transportation services will be granted for a period of 30 years, renewable for another 30 years. The concession may be assignable, with the authorization of the ANP. The ANP’s authorization also is required for changes in control affecting the concession holder.
Planning and Expansion

The MME will propose, on its own initiative or as requested by third parties, and based on planning studies, new pipelines or the expansion of existing pipelines. The MME may also utilize public-private partnerships and certain specified resources to enable the construction of gas pipeline projects that are deemed to be in the public interest. New pipeline construction and expansion projects will be preceded by an open season intended to identify potential shippers and gauge the level of interest in the project. Existing concession holders will have a preference to undertake expansion projects. The principal criterion to be applied in awarding concessions for transportation will be the lowest annual revenue requirement.

Tariffs and Quality

The ANP will establish initial maximum tariffs as part of the open season process to be adjusted based on the annual revenue requirement established through the concession process. The ANP also will regulate natural gas quality. The ANP will issue further regulations regarding the terms and conditions for open access to natural gas pipelines. Such rules will take into account gas quality issues and the rights of existing shippers.

Storage

Entities engaged in natural gas storage activities also must be formed under Brazilian law and headquartered in Brazil. Several details regarding the concession process for storage activities depend on further regulation by the MME or ANP.

Distribution and Sale

Free consumers, self-producers and self-importers may be authorized to bypass local distribution companies for supply of natural gas through separate lines built by the consumer but operated by the local distribution company. Sales contracts must be registered with the ANP. Any company formed under Brazilian law and headquartered and managed in Brazil may apply for authorization to export and import natural gas.

Contingency Provisions

The law provides that under certain extraordinary circumstances, in which the demand for natural gas cannot be met, the natural gas transportation and supply obligations may be suspended and the MME will coordinate the implementation of a plan to address, among other things, the priority of curtailments.

Savings Provisions

The law does not affect existing supply arrangements in place for fertilizer companies and petroleum refineries.

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