



# Gas Regulation

in 36 jurisdictions worldwide

Contributing editors:

Florence Ninane, Alexandre Ancel and Jean-Yves Ollier

# 2011



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# United States

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## 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 upstream segments of the United States gas sector are conducted by the same kinds of entities that engage in the exploration and production of liquid hydrocarbons. These segments are characterised by a variety of private parties, from individual entrepreneurs to large integrated firms, engaged in securing grants of licences and leases to explore for and produce valuable substances. Processing of gas and fractionation of natural gas liquids (NGLs) can occur in the field by the lessee, or downstream in plants on gathering or trunk lines between the field and the main trunkline pipeline systems. The midstream and downstream segments of gas and LNG storage, trunkline transportation and local distribution are typically conducted by private entities subject to public utility regulation at the federal or state level, or by municipal utility districts.

The US (including Puerto Rico) has 11 LNG terminals. Nineteen terminals have been permitted to be built or expanded by utilities, private and publicly traded development firms, and oil companies with gas production in the developing world.

There are approximately 305,000 miles of natural gas pipelines in the US, approximately 70 per cent of which consists of interstate pipelines. At the end of 2008, the interstate natural gas pipeline grid consisted of about 183 billion cubic feet (bcf) per day of capacity and approximately 217,000 miles of pipeline. The grid continues to grow: in 2009, 43 natural gas pipeline projects were completed, adding close to 3,000 miles, down significantly from 2008, which was the largest expansion in the past ten years.

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

According to the Energy Information Administration (EIA), in 2009 natural gas (including LNG) accounted for nearly one-quarter of US energy consumption. Natural gas consumption was approximately 22.8 trillion cubic feet (tcf); roughly 87 per cent of that demand – about 21 tcf – was met through domestic production. Net imports satisfy the balance of demand. In 2009, imports amounted to 3.75 tcf, comprised of pipeline imports (83 per cent) and LNG (17 per cent). Most of the natural gas that the US imported via pipeline in 2009 was from Canada (87 per cent), with about 1 per cent coming from Mexico. More than half of the LNG that the US imported in 2009 – about 52 per cent – came from Trinidad and Tobago while 35 per cent came from Egypt.

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

A central feature of US governmental policy for the domestic natural gas sector is to prevent firms with monopoly power from being able to abuse that power. However, this is balanced by policies that support increased gas production and, for limited parts of the sector, deregulation and the promotion of competitive market forces. Policies are set by the legislative and executive branches of both federal and state governments, with significant delegation of authority to administrative agencies that are part of the executive branch, particularly the Federal Energy Regulatory Commission (FERC).

## 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?

In contrast to the oil sector, in which some companies are active in all segments, it is more common for companies in the natural gas sector to concentrate on two or three segments (eg, production and gathering, or transmission and storage). Ownership of pipeline transportation capacity is separated from ownership of the natural gas transported via pipeline, although some Canadian producers also own natural gas pipelines that cross from Canada into the US.

The federal government does not participate directly as a party in private natural gas production transactions. It derives value from natural gas production through the royalties, annual rentals, and bonus payments it receives for production on federally owned lands. During 2010, in response to the Deepwater Horizon oil spill in the Gulf of Mexico, the Department of Interior (DoI) renamed the Minerals Management Service (MMS) the Bureau of Ocean Energy Management, Regulation and Enforcement (BOEMRE) and split the MMS' competing responsibilities of development of natural resources, collection of royalties and enforcement of environmental and safety regulations amongst three different divisions. The Bureau of Ocean Energy Management (BOEM) division of BOEMRE is responsible for managing the development of the nation's offshore energy resources in an economically and environmentally responsible way, while the Bureau of Safety and Environmental Enforcement (BSEE) bears responsibility for enforcement of safety and environmental regulations. The revenue collection responsibilities of the former MMS have been delegated to the Office of Natural Resources Revenue. In addition, government agencies impose a variety of taxes and charges. FERC, for example, is authorised to recoup its entire budget appropriation through the imposition of annual charges and filing fees.

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

### Production, drilling and supply

Natural gas producers are not directly regulated by the federal government. The prices they charge are generally a function of competitive markets, and are no longer regulated by the government. State public utility commissions generally exercise regulatory authority over retail natural gas rates and consumer protection issues.

### Transmission

FERC is the primary federal regulatory agency governing natural gas transmission. FERC has jurisdiction over the regulation of interstate pipelines and is concerned with overseeing the implementation and operation of the natural gas transportation infrastructure. In addition, FERC has primary regulatory authority to permit, site, and approve onshore LNG import terminals.

State authorities regulate substantial pipeline capacity that is considered to be 'intrastate'.

### Distribution

State regulatory utility commissions have oversight of issues related to the siting, construction, and expansion of local distribution systems.

- FERC's regulatory authority extends to the interstate transportation of natural gas, the importing of natural gas by pipeline or LNG import terminals, and certain environmental and accounting matters. FERC obtains its authority and directives in the regulation of the natural gas industry from a number of laws; namely the Natural Gas Act of 1938, the Natural Gas Policy Act of 1978, the Outer Continental Shelf Lands Act, the Natural Gas Wellhead Decontrol Act of 1989, the Energy Policy Act of 1992 and the Energy Policy Act of 2005.
- The Office of Pipeline Safety of the Department of Transportation (DoT) has jurisdiction over pipeline safety.
- State public utilities commissions have jurisdiction over retail pricing, consumer protection, and natural gas facility construction and environmental issues not covered by FERC or DoT.

FERC is designed to be independent from influence from the executive or legislative branches of government, or industry participants, including the energy companies over which it has oversight. FERC is composed of five commissioners, who are nominated by the president of the US and confirmed by the US Senate. Each commissioner serves a five-year term, and one commissioner's term is up every year.

DoI and DoT are cabinet-level agencies, and their respective secretaries are chosen by the president subject to Senate confirmation.

There are several adjudicatory options for challenging or appealing decisions of the regulator. The Commission may make a decision without any further procedures, it may hold a trial-type hearing before an administrative law judge, or it may hold a technical conference or 'paper' hearing. Alternate dispute resolution, like mediation and arbitration, may also be used. FERC decisions may be appealed to the federal Courts of Appeal.

Where FERC is implementing a federal statute, the plaintiff must usually show that FERC's implementation is an 'arbitrary and capricious' interpretation of the federal statute. This is a very high standard that is rarely satisfied. Additionally, a party must show that it has standing to bring the suit and satisfy other justiciability concerns such as ripeness and mootness.

The government authorisations required to carry on natural gas exploration and production activities depend on whether the proposed project is to be conducted on federal, state or privately-owned land, and whether it is proposed to be conducted onshore or offshore.

### Federal lands

Federal lands are managed by DoI. Within DoI, the BOEMRE regulates offshore drilling and the Bureau of Land Management (BLM) regulates onshore drilling.

### Offshore

The BOEMRE now oversees the management of the mineral resources on the OCS (generally beyond three miles from the coast) through its two divisions (BOEM and BSEE), and is charged with ensuring that production and drilling on the OCS are conducted in a safe and environmentally responsible manner. DoI prepares a five-year programme that specifies the size, timing and location of areas to be assessed for federal offshore natural gas leasing. Bids are usually solicited on the basis of a cash bonus and a royalty agreement, with the highest bidder awarded the lease. Additionally, although FERC has traditionally assumed authority over OCS pipelines, the predecessor of BOEMRE began regulating OCS pipelines in 2008, pursuant to the decision of the US Court of Appeals for the District of Columbia in *Williams Cos v FERC*, and subsequently passed a final rule to ensure open access to OCS pipelines by providing complaint procedures for shippers for oil and gas produced from federal leases on the OCS who believe that they have been denied open and non-discriminatory access to an OCS pipeline. It is likely that there will be significant new developments in the regulation of offshore drilling practices in the aftermath of the Deepwater Horizon oil spill in the Gulf of Mexico in 2010; however, the extent and the substance of any such modifications remain to be seen.

### Onshore

BLM is charged with managing and conserving federally owned land, including the natural gas resources. Unless they are specifically carved out of the leasing programme, all BLM-managed lands and national forests are open to leasing. Gas leasing is generally not permitted in the national park system, in national wildlife refuges, in the Wild and Scenic River Systems, and in wilderness areas. Leasing in national forests requires specific permission from the Forest Service. BLM reviews and approves permits and licenses for companies to explore, develop, and produce natural gas on federal lands. Once projects are approved, BLM enforces regulatory compliance.

### State lands

Drilling on state lands is managed by State Departments of Natural Resources and related agencies. Coastal states additionally have authorisation rights over submerged lands and 'inland waters' within three miles of the coast. Each state has its own sets of requirements and regulations governing the leasing of such state-owned lands.

### Privately owned lands

The leasing of private land is generally left up to each individual landowner.

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## Regulation of natural gas pipeline transportation and storage

- 6** Describe in general the ownership of natural gas pipeline transportation and storage infrastructure.

Pipeline transportation and storage of natural gas are conducted by the private sector. According to the EIA, there are 182 companies operating natural gas pipelines in the United States. Private companies in the US operate over 400 underground storage facilities, mainly in depleted reservoirs, aquifers and salt caverns.

- 7 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.

Pursuant to section 7 of the NGA, interstate pipelines and gas storage facilities must obtain certification from FERC before constructing or expanding facilities. Intrastate gas transmission and distribution facilities are certificated by state and local authorities.

Under applicable statutes, FERC will issue a certificate to a pipeline if there is a benefit to the public, including compliance with environmental standards. Current FERC policy is generally to issue certificates to all pipelines that comply with the statutory standards, but to let the market decide which pipelines will be built.

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

The location, construction and operation of interstate pipelines, facilities, and storage fields involved in moving natural gas across state boundaries must be approved by FERC. The pipeline company proposes the route or location, which is then reviewed by FERC. If a proposed pipeline route is on or adjacent to private land, the company will inform the private landowners and obtain any necessary rights-of-way (or alternative access rights) prior to construction. The applicant must consider alternative routes or locations to avoid or minimise the effects on such things as buildings, fences, crops, water supplies, soil, vegetation, wildlife, air quality, noise, safety and landowner interests. FERC staff will consider whether the pipeline can be placed near or within an existing pipeline, power line, highway or railroad right-of-way. A pipeline certified by FERC has eminent domain authority. Storage fields are usually located in depleted oil or natural gas production fields or in salt deposits.

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

There are essentially three major types of pipelines along the transportation route: the gathering system, the transmission pipeline, and the distribution system. The gathering system transports raw natural gas from the wellhead to the processing plant. Transmission pipelines use higher pressure and larger diameter pipes to move natural gas quickly over long distances, and are typically interstate but can be intrastate. Interstate pipelines carry natural gas across state boundaries, whereas intrastate pipelines transport natural gas within a particular state. Interstate natural gas pipeline networks transport processed natural gas from processing plants in producing regions to those locations with high natural gas requirements, particularly large, populated urban areas. Distribution systems deliver the natural gas to homes, businesses and power plants.

Transportation of natural gas is closely linked to its storage. If the natural gas being transported is not required at the time, it can be put into storage facilities for when it is needed. Natural gas pipeline companies have customers on both ends of the pipeline – the producers and processors that deliver gas into the pipeline, and the consumers and local distribution companies that take gas out of the pipeline.

In accordance with FERC rules, access to interstate natural gas transportation and storage services must be provided on a non-discriminatory basis. Generally, purchasers of gas interstate transportation and storage services negotiate individual contracts with pipeline and storage companies, which are subject to the service provider's tariff as approved by FERC. Where there is limited capacity for interstate storage or transportation, capacity is allocated through a bidding process in which the pipeline or storage capacity is generally awarded to the highest bidders. Under FERC rules, the terms and rates charged for all interstate pipeline transportation and stor-

age services must be applied in a non-discriminatory manner, not be unduly restrictive and be fair to all parties.

- 10 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?

FERC is authorised under section 7(a) of the NGA to order a company to establish physical connection of its transportation facilities with the facilities of, and sell natural gas to, persons engaged in local distribution of natural or artificial gas to the public if FERC finds that it is 'necessary or desirable in the public interest' to do so and that 'no undue burden will be placed upon a natural gas company'. Customers and natural gas suppliers can petition FERC to order an expansion of interstate natural gas transportation facilities. FERC is prohibited from compelling the enlargement of transportation facilities, the establishment of physical connection, or the sale of natural gas if those actions would impair a natural gas company's ability to render adequate service to its existing customers. The costs of such expansion shall be considered in determining rates to be charged for service by the natural gas company.

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

The processing of natural gas is largely unregulated at the federal and state levels except for applicable environmental, health, safety and related regulations. Processing facilities not directly involved in jurisdictional (interstate) transportation of gas are generally exempt from FERC jurisdiction.

- 12 Describe the contractual regime for transportation and storage.

Each pipeline and storage company providing gas transportation and storage services subject to FERC jurisdiction is required to file and obtain FERC approval of a tariff for such services. Each tariff contains the general terms and conditions of service, rate schedules and form agreements. General terms and conditions in both transportation and storage tariffs typically address priority and curtailment of service; nominations and scheduling; receipt and delivery points; quality and pressure; title and risk of loss; measurement; fuel reimbursement; and balancing. Transportation rate schedules typically set forth maximum and minimum rates for the various types and classes of service, and mutually agreed recourse rates that are no less than the minimum tariff rate.

Contracts for intrastate transportation and storage of natural gas can also be privately negotiated. In many states, these contracts are subject to the provider's tariff that has been filed with a state governmental authority, but typically do not require advance approval.

### Regulation of natural gas distribution

- 13 Describe in general the ownership of natural gas distribution networks.

In addition to interstate and intrastate pipeline companies, which deliver natural gas directly to primarily large-volume users, natural gas local distribution companies (LDCs) transport gas to specific customer groups. In 2006, 257 LDCs classified themselves as investor-owned, 931 as municipals, 104 as privately owned and 15 as cooperative. Even though the number of municipal LDCs far exceeded the number of investor-owned LDCs, investor-owned LDCs supplied over 90 per cent of the total volume of natural gas deliveries for 2006.

- 14** 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?

The operation of a local distribution network by an LDC is governed by the state regulatory authority with jurisdiction where the facilities are located. The LDC may be required to obtain certificates of convenience and necessity to serve in the state and comply with all applicable safety regulations. The territories granted to LDCs are typically exclusive.

Service by LDCs is generally required to be non-discriminatory and at rates approved by the state regulatory authority. While each LDC retains the right to disconnect service for non-payment, those rights are subject to consumer protection regulations in most jurisdictions. However, LDCs are protected in most states by an implied right to obtain a reasonable rate of return on their investments.

- 15** 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?

State and federal regulatory agencies have authority over access to the natural gas distribution grid and, as a result, the requirements differ from state to state. Generally, LDCs are granted the exclusive right to serve customers within a geographic area. An LDC has the benefit of a known customer base, but is also subject to rate regulation and an obligation to provide service. In many states, large customers have the ability to bypass the LDC with respect to the purchase of gas because of their ability to buy in significant quantities; however, even these customers will need to avail themselves of the LDC's distribution services. In some circumstances, large retail customers can receive service directly from interstate pipelines through FERC-approved laterals, thus bypassing the LDC completely.

Privately owned LDCs generally have their rates determined by the state regulatory authority, but the rates of publicly owned LDCs are normally set by the LDC's governing body. Rates typically allow the LDC a reasonable return on investment, based on the cost of providing service. Bundled rates include fees for access to the distribution system.

Periodic adjustments may be made to rates and terms of service, either at the LDC's request or by order of the governing state regulatory authority. Changes are typically made on the basis of changes in operating costs or the applicable law. New capital investments may also be the basis for a rate increase request.

- 16** 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?

If an LDC has been granted an exclusive right to serve within a particular geographic area by state law, it will also generally be required to extend its system to serve new customers within that area, if it can do so without jeopardising the service provided to existing customers. The process for expanding an existing system (including issues such as the manner in which costs of expansion are recouped) is set forth in state statutes or regulations.

- 17** Describe the contractual regime in relation to natural gas distribution.

Most contracts for natural gas distribution are either established by a filed tariff or bilateral service agreements with terms specific to the customer being served with respect to terms such as quantity of the commodity and the type of service. However, certain terms of service will likely be the same for all customers of the LDC in the same class. There is typically little flexibility for negotiation for individual customers with respect to the terms of a service agreement.

## Regulation of natural gas sales and trading

- 18** What is the ownership and organisational structure for the supply and trading of natural gas?

Natural gas is supplied and traded by private-sector companies, pursuant to privately negotiated transactions. These companies can be privately or publicly owned and range in size from entrepreneurs to very large organisations, but counterparties value creditworthiness and staying power in their trading partners.

- 19** To what extent are natural gas supply and trading activities subject to government oversight?

Under the current regulatory regime, only pipelines and LDCs are directly regulated. Interstate pipeline companies are regulated in the rates they charge, the access they offer to their pipelines, and the siting and construction of new pipelines. Similarly, LDCs are regulated by state utility commissions, which oversee their rates and construction issues, and which ensure that proper procedures exist for maintaining adequate supply to customers.

While there is no direct government agency charged with direct day-to-day oversight of natural gas producers and marketers, producers and marketers must still comply with other laws including authorisation and permitting requirements.

The trading of natural gas is largely market-driven; however, rules are in place to ensure that the market is operated fairly. FERC has also implemented 'anti-manipulation' rules that prohibit fraudulent or deceptive practices and omissions or misstatements of material facts in connection with purchases or sales of natural gas or transportation services subject to FERC jurisdiction.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), enacted on 21 July 2010, granted new oversight and rulemaking authority to the Commodity Futures Trading Commission (CFTC) to regulate derivatives transactions, including trades involving energy commodities such as natural gas. Many transactions previously exempt from regulation under the Commodities Exchange Act will be regulated under Dodd-Frank.

The CFTC now has oversight authority for a wide range of practices in the over-the-counter derivative market, requiring registration of swap dealers and major swap participants, imposing capital and margin requirements on participants, requiring that derivatives trading take place on regulated exchanges or swap execution facilities, and creating a derivatives clearinghouse.

Dodd-Frank includes an 'end user' exception, allowing an exemption from clearing and exchange trading requirements for trades in which one party is not a 'financial entity' (as defined by Dodd-Frank); the purpose of the trade is to mitigate 'commercial risk' (to be defined by the CFTC); and the entity notifies the CFTC how it will meet its financial obligations associated with entering into uncleared swaps (to be defined by the CFTC). As of the date of this publication, the CFTC is currently drafting rules defining key terms in Dodd-Frank and is accepting public comment in 30 rulemaking and administrative areas; rulemaking must be finalized by 16 July 2011. However, as of the date of this publication, it is unclear whether the CFTC will meet this deadline because of significant controversy arising from proposed regulations. The CFTC and FERC are also currently negotiating a memorandum of understanding resolving jurisdictional and oversight issues created by the CFTC's new regulatory power.

- 20** How are physical and financial trades of natural gas typically completed?

There are two primary types of natural gas marketing and trading: physical trading and financial trading. Physical trading is the buying and selling of natural gas. Financial trading, on the other hand,

involves derivatives and other financial instruments where the buyer and seller never take physical delivery of the natural gas. The North American Energy Standards Board (NAESB) serves as an industry forum for the development and promotion of standards for natural gas and electricity markets.

Physical trading contracts are negotiated between buyers and sellers. There are numerous types of such contracts but they normally contain standard terms, such as specifying the buyer and seller, the price, the amount of natural gas to be sold, the receipt and delivery points, and the term of the contract. Additional terms and conditions outline the payment dates, quality specifications and any other provisions agreed to by both parties.

There is a significant market for natural gas derivatives and financial instruments in the US. It has been estimated that the value of trading that occurs on the financial market is 10 to 12 times greater than the value of physical natural gas trading.

Natural gas derivatives are traded on the New York Mercantile Exchange (NYMEX) and other exchanges. One of the most common derivatives is a futures contract that requires the seller to deliver and the buyer to take delivery of the natural gas at the contractually agreed price, in a specified future month. The price to be paid in the future month when the contract matures is determined at the time the contract is sold. Other natural gas derivatives include options contracts, calendar spread options and basis swap futures contracts. In addition to the derivatives available on NYMEX, other derivatives are traded in over-the-counter (OTC) markets.

The International Swaps and Derivatives Association (ISDA) has created a standard contract (the ISDA master agreement) for OTC derivatives transactions, which can be used for physical and financial trades as well. The ISDA master agreement contains general terms and conditions, such as provisions relating to payment netting, tax gross-up, tax representations, basic corporate representations, basic covenants and events of default and termination, but does not include details of any specific derivatives transactions the parties may enter into. Details of individual derivatives transactions are included in 'confirmations' entered into by the parties to the ISDA master agreement. Each confirmation sets out the agreed commercial terms of a particular transaction.

- 21** 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.

In Order No. 636, FERC required interstate pipelines to separate or unbundle their services for gas transportation and sales. Regulators in many states have also required LDCs to offer unbundled sales and transportation services for large customers located in their distribution systems. As a result, LDCs, large industrial customers, and electric utilities can now buy gas directly from producers or marketers in a competitive market; contract with interstate pipelines for transportation; and separately arrange for storage and other services formerly provided by interstate pipelines or LDCs (such as nominating, balancing, parking, loaning, metering and billing) from marketers, market centres, hubs, storage operators, and other third-party providers.

Some state regulatory agencies allow smaller-volume customers to participate in aggregation programmes in order to purchase unbundled services. As of December 2009, 21 states and the District of Columbia have allowed residential consumers and other small users to purchase natural gas from suppliers other than LDCs. Such customers are typically offered unbundled services on a limited basis through an intermediate marketer who 'rebundles' the services and offers them as a competitively priced alternative. Where unbundled LDC services are available, some states require the smaller customers to purchase a standby service from the LDC. Although nearly 35 million of the approximately 65 million residential gas customers in the US have access to choice programmes, 15 per cent (5.1 million) are

participating in such programmes as of December of 2009 – a modest increase from 2008 (4.7 million).

## Regulation of LNG

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

All currently operating US LNG facilities are ultimately owned by US or foreign private companies. Ownership structures vary from project to project and may include direct ownership by a single entity, joint ventures among two or more parties, or many other possible structures. Terminals may be operated either on a 'tolling' basis, where the terminal operator does not take title to the hydrocarbons, or with passage of title to or from the terminal operator or owners before or after completion of the regasification process.

- 23** Describe the regulatory framework and any relevant authorisations required to build and operate LNG facilities.

For offshore LNG facilities, the US Coast Guard (the USCG) and the Maritime Administration (MARAD) of DoT have joint authority over the application process. In accordance with the National Environmental Policy Act (NEPA) and the Deepwater Port Act of 1974 (the DPA), the USCG oversees the preparation and review of an environmental impact statement, which addresses the environmental impact that a proposed offshore facility would have on the environment.

MARAD has ultimate jurisdiction for approving or denying an application to construct and operate an offshore LNG facility. Its decision is based on input from the USCG and several other federal agencies, including the Environmental Protection Agency (the EPA), DoI's BOEMRE and the US Army Corps of Engineers.

Also, the DPA provides that the governor of a state adjacent to the proposed offshore facility must approve of the facility.

For onshore LNG facilities, which represent the majority of existing and proposed facilities in the US, the NGA confers on FERC the authority to approve or deny an application to develop an LNG terminal. While FERC has ultimate decision-making authority, several other federal, state and local agencies play a role in the process. These agencies include the USCG, with respect to marine transit issues relating to LNG tankers, the US Army Corps of Engineers, DoI and the EPA with respect to environmental impacts, and the Office of Pipeline Safety with respect to issues relating to siting, design, construction, testing, operation and safety of the facilities (including any pipelines associated with such facilities). Various state and local land, environmental, wildlife and historical preservation agencies also play a role in approving or denying a proposed facility.

Recently, several LNG import facilities have sought export authorisations from the Department of Energy (DoE) for LNG (whether previously imported or not). Additionally, several LNG terminal owners have discussed (and one has actually filed) seeking authorisation from FERC for the construction of liquefaction facilities at the LNG terminal site. This would require approval from FERC pursuant to section 3 of the NGA and the appropriate order from DoE with respect to the destination countries for such exports (ie, Free Trade Agreement (FTA) countries, World Trade Organization (WTO) countries and non-WTO countries).

- 24** Describe any regulation of the prices and terms of service in the LNG sector.

LNG terminals built after FERC's *Hackberry* decision and the passage of the Energy Policy Act of 2005 are not required to offer open access to any qualified customer. Instead, the owner of the terminal may operate the terminal in accordance with market conditions,

thereby offering access to customers of its choosing at prices and on such terms and conditions as may be agreed between the owner and the customer. The terms and conditions of such access are generally reflected in a terminal use agreement between the terminal owner and the customer. However, open access requirements do still apply to interstate pipelines transporting regasified LNG from LNG terminals in the US.

### Mergers and competition

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

Prohibitions of anti-competitive and manipulative conduct are found in federal and state laws of general application (called 'antitrust laws' in the US), and in the laws and regulations applicable to public utilities in particular. The antitrust laws include the Sherman Act (combinations in restraint of trade, monopolisation), the Clayton Act (mergers, exclusive dealing) and the Robinson-Patman Act amendments to the Clayton Act (discrimination on price and other terms of sale), and are enforced at the federal level by the Federal Trade Commission (FTC) and the antitrust division of the Department of Justice (DoJ); the FTC may also enjoin unfair acts of competition under the Federal Trade Commission Act (FTC Act). Many states have analogues to some or all of the federal antitrust laws, and some of the state laws have particular application to petroleum products, including natural gas. The main federal and state antitrust laws are also enforced by state attorneys general, local governmental bodies and in some cases by private parties injured by the conduct in question.

The governmental bodies responsible for regulation of public utilities enforce their own rules, particularly FERC and the various state public utilities commissions (PUCs). FERC created its own Office of Enforcement (superseding the former Office of Market Oversight and Investigations) with responsibility for identifying and taking action against fraud and anti-competitive practices in electricity and gas sectors. The Energy Policy Act of 2005 broadened the scope of FERC's rule-making and enforcement authority under the NGA to prevent market manipulation. Competition principles also inform the review and approval by these bodies of the rates and terms and conditions of tariffs for interstate and intrastate transportation and storage service.

The recent enactment of Dodd-Frank will provide increased oversight of anti-competitive or manipulative practices with regards to commodities (including natural gas) by delegating enhanced authority to the CFTC. The rulemaking process is still ongoing and must be completed and enacted by 16 July 2011, though it is uncertain the CFTC will meet this deadline because of controversy surrounding these regulations.

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

The antitrust laws generally draw a distinction between conduct that is highly likely to be anti-competitive without redeeming justification and per se unlawful (eg, cartels), and conduct whose anti-competitive effects must be examined and weighed against any justifications, employing a 'rule of reason'. The definition of the relevant geographical and product market, and measures of industrial concentration within that market, must be evaluated under the rule of reason and for other antitrust laws dealing with market power and monopolisation offences. The FTC Act and similar acts enjoining unfair competition employ a wider variety of standards that may not fall within the scope of specific laws, potentially including manipulation of prices or price indices.

Congress delegated authority to the CFTC to increase oversight by expanding the CFTC's authority to regulate manipulative conduct with respect to certain commodities in interstate commerce (including

natural gas), as well as futures, derivatives and over-the-counter swap markets. While the CFTC is still in the process of developing its new rules, the most recent proposal would implement regulations that are largely based on Securities and Exchange Commission (SEC) Rule 10b-5 and similar standards already in place at FERC and the FTC. Rule 10b-5 is the most predominant regulation covering manipulative conduct associated with the purchase or sale of publicly traded securities. The Rule prohibits conduct such as fraud, deceit, misrepresentation and manipulation in connection with the trading of securities, and authorises both government and private enforcement.

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

All of the federal and state antitrust enforcement agencies have power to seek monetary damages and a variety of equitable remedies for violation of the laws they are authorised to enforce; many of these laws carry criminal penalties, and damages can be trebled or otherwise subject to increase for punitive or exemplary purposes. Federal and state agencies have the power to revoke authorisations for market-based rate-making in the event that an entity is found to have engaged in anti-competitive practices. Violations of an unfair competition law are ordinarily subject to an injunction but a violation of that injunction can result in fines. Private parties can seek damages for injuries to them occasioned by violation of the laws, and in some cases can bring class actions for others similarly situated.

Pursuant to the Energy Policy Act of 2005, FERC has the authority to issue rules to inhibit market manipulation and to facilitate price transparency in natural gas markets. FERC has recently instituted regulations that require certain gas market participants to annually report information regarding their wholesale, physical natural gas transactions; their reporting of transactions to price index publishers; and their blanket certificate status. Similar regulations require interstate and certain major non-interstate pipelines to post capacity, daily scheduled flow information and daily actual flow information.

In addition, the Energy Policy Act of 2005 confers greater enforcement authority to FERC in order to prevent market manipulation. FERC has the ability to seek injunctions prohibiting those who have engaged in energy market manipulation from further engaging in activities subject to FERC's jurisdiction. The Act also increases the maximum civil penalties to US\$1 million per violation per day, and increases the maximum criminal penalties to US\$1 million per violation and up to five years' imprisonment.

With the ensuing regulatory implementation of Dodd-Frank, the CFTC will have authority to seek an injunction and penalise manipulative or anti-competitive behaviour. The current CFTC rulemaking proposal would establish penalties identical to FERC's penalties; however, these penalties will not be finalised until the formal rule-making process is completed.

**28** 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?

Mergers and certain changes in control are subject to notification to the FTC and DoJ under the Hart-Scott Rodino Antitrust Improvements Act of 1976, as amended (HSR Act). (Natural gas transactions are usually reviewed by the FTC.) The reportability of a transaction depends on the size of the transaction and in certain circumstances the size of the parties thereto. A higher threshold exists for acquisitions of natural gas and oil reserves and associated production assets, including gathering pipelines; that minimum is US\$500 million. For midstream and downstream transactions, transactions greater than US\$63.4 million may require review. The structure of the transaction – whether a merger, contributions to an existing business, or other forms – can also affect whether the deal is reportable.

The purpose of the requirements is to provide the enforcement

agencies with the information needed to evaluate whether the combination would violate the antitrust laws, and the time needed to seek an injunction in court barring the deal from proceeding. The parties ordinarily may not consummate the transaction until 30 days after the filing (though the agencies can make a second request for more information and stop the clock while the additional information is assembled and delivered). For non-controversial transactions, as is typical in the upstream sector, the agencies grant an early termination of this waiting period, and a merger can be completed in two weeks from the filing. For controversial transactions, the agencies may signal their willingness to enter into a consent decree conditioned on certain divestitures or promises to engage or refrain from engaging in certain acts; or the parties can enter into sustained negotiations or litigation occupying months. Moreover, the agencies can forego the opportunity to enjoin the merger and instead challenge it long after the deal has closed. This has occurred several times in the energy sector.

FERC itself has limited grounds for reviewing mergers in the natural gas sector. In some cases, FERC action must be taken for issuance or revision of certificates of public convenience and necessity, or for abandonment of assets under the NGA.

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

The purchase of a regulated gas utility is subject to state regulation. Upon purchase of a regulated utility, most states will set rates based on the net book value of facilities instead of the purchase price. Additionally, states typically bar the inclusion of any acquisition premium in rates.

- 30** 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?

With the repeal in 2005 of the Public Utility Holding Company Act of 1935, there are no general federal prohibitions on entities that may own a gas utility company or requirements for registration with the SEC. However, acquisition of assets that have been dedicated to use by public utilities is often also subject to review and approval by the state commission with jurisdiction. An example is section 851 of the California Public Utilities Code, requiring approval by the California Public Utilities Commission.

## International

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

There are no special requirements or limitations on foreign companies acquiring interests in the natural gas sector. However, an entity applying for certification of a liquefied natural gas facility under section 3 of the NGA and the regulations issued pursuant to that section by FERC is required to disclose on the application any ownership by a foreign government or subsidisation by a foreign government. In addition, under the Exon-Florio Amendment to the Defense Production Act of 1950, the Committee on Foreign Investment in the United States (CFIUS) reviews proposed foreign investments in US facilities to determine whether such investment threatens US national security. Exon-Florio was amended by the Foreign Investment and National Security Act of 2007 (FINSIA) and now expressly treats 'energy security' and 'critical infrastructure' as falling within the concept of national security; the law now mandates full-scale CFIUS review where the proposed purchaser is owned by a foreign government. Finally, there are other laws applicable to the natural gas industry restricting foreign ownership, including the Mineral Lands Leasing Act, which forbids aliens and foreign corporations from directly owning mineral leases on federal lands.

- 32** To what extent is regulatory policy affected by treaties or other multinational agreements?

While treaties and other multinational agreements have little direct effect on purely domestic US gas regulatory policies, they do have an effect on international importing, exporting and trading of natural gas. Multilateral agreements entered into by the US and other members of the World Trade Organization (WTO) typically dictate how WTO members may treat goods exported from other WTO members, including gas and other petroleum products.

However, in the event of a conflict between a regional trade agreement and a WTO trade agreement, the regional trade agreement pre-empts the WTO trade agreement. For example, the North American Free Trade Agreement (NAFTA) allows for duty-free imports and exports of gas among the US, Canada and Mexico.

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

The NGA prohibits the import or export of natural gas to or from the US without obtaining the prior approval of the DoE. The DoE offers two types of import and export authorisations: long-term authorisation and 'blanket' (short-term) authorisation.

Long-term authorisation must be sought by a party wishing to import or export natural gas pursuant to a signed gas purchase and sale contract that has a term longer than two years. The applicant must submit to the DoE: an application, a copy of the gas purchase and sale contract identifying the seller of the gas and the markets in which the gas will be sold, and the term of the contract.

In addition, with the potential development of liquefaction facilities for LNG in the US, DoE will also be requested to issue orders pertaining to the long-term, multi-contract export of domestically produced natural gas. Such orders may be specific to the destination countries for the exported product. Export to FTA countries (as of the date of publication, such countries include: Australia, Bahrain, Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, Chile, Morocco, Canada, Mexico, Oman, Peru, Singapore and Jordan) is governed by section 3(c) of the NGA (ie, such exports are deemed to be in the public interest and applications for such authority are required to be granted without modification or delay). Alternatively, to export to countries with which the US does not currently have an FTA in place, the exporter must also seek approval from DoE. The first applications of this type for LNG are currently pending with DoE and DoE has recently indicated that these requests will be considered pursuant to section 3(a) of the NGA, regardless of whether such export is to a WTO member nation or a non-WTO member nation.

Vessels that are importing LNG into the US are deemed to pose a special security risk. The USCG and the US Bureau of Customs and Border Protection scrutinise such vessels more so than many other vessels importing cargo into the US, which often results in delays in the delivery and unloading of LNG.

Like most goods imported into the US, gas imports are subject to US customs regulations. While many of these regulations apply uniformly across products, in the case of bulk petroleum imports certain additional information is required in order for imports to be cleared by customs.

## Transactions between affiliates

- 34** What restrictions exist on transactions between a natural gas utility and its affiliates?

In October 2008, after a state of flux, FERC issued Order No. 717, which amended the Standards of Conduct governing, among other things, transactions by jurisdictional natural gas transmission providers and their affiliates. Order No. 717 designed new rules to foster compliance with the Standards of Conduct, to facilitate enforcement by the commission and to conform the rules to the 2006 decision of

the US Court of Appeals (DC Circuit) in *National Fuel Gas Supply Corporation v FERC*. The standards now have three principal rules:

- the ‘independent-functioning rule’, which requires employees handling transmission functions and employees handling marketing functions (such as commodity sales) to operate independently of each other;
- the ‘no-conduit rule’, which prohibits employees of a transmission provider from passing information about transmission functions to marketing function employees; and
- the ‘transparency rule’, which imposes streamlined posting requirements on transmission providers to help FERC and other interested parties detect any instances of undue discrimination or preference.

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

FERC has enforcement authority with respect to its regulations governing transactions between a natural gas utility and its affiliate. It has the ability to impose sanctions that could include restrictions or revocation of operating authority and the right to impose civil penalties.

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#### Update and trends

With the recent doubling of the US Energy Information Administration's estimate of the amount of technically recoverable shale gas reserves in the US to 827,000BCF, the US is facing an unprecedented surplus of domestic natural gas. Couple this surplus with natural gas prices which have dipped to historic lows in the US over the past few years and which are forecasted to remain relatively low and this creates an environment ripe for changes to the way natural gas is viewed in the US: namely, as a potential product for export.

While natural gas prices have remained low in the US, prices in the UK and Asia have remained higher. The increase in arbitrage of LNG has served to close the gap between these prices somewhat; however, until LNG becomes a truly global commodity, the US could stand to reap significant financial rewards from developing an export market for domestically produced natural gas. Indeed, several US LNG industry participants are betting on just that turn of events.

It remains to be seen whether prices will remain depressed in the US and whether LNG will ever create a completely flat international market; however, with decreasing costs of domestic shale gas production and the availability of liquefaction facilities in possibly as few as four years, exports of domestic natural gas could quickly become a fixture in the global natural gas market and a boon to attempts to close the US trade deficit.



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