



# Gas Regulation

in 36 jurisdictions worldwide

# 2011

Contributing editors:

Florence Ninane, Alexandre Ancel and Jean-Yves Ollier



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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 that already has a complex commercial history. The introduction of natural gas for industrial and residential use only dates back to 1997, when a transportation pipeline, named 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, a new era of tensions started due to the fact that Argentina imposed export restrictions on the gas coming to Chile. Finally, a third period of natural gas's history has recently begun with the inauguration of LNG terminals, now supplying central and northern parts of Chile. The LNG plants should mean a more secure and reliable source of natural gas and should also increase the share of gas in the national energy matrix. Chile has limited conventional energy resources and has a high dependence on the import of energy resources, with more than 95 per cent of its oil and more than 75 per cent of its natural gas coming from foreign sources. A summary of the main business areas in the natural gas sector are as follows:

#### Gas exploration and production

Domestic gas exploration and production is very limited and 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. According to recent press releases, production in that area is at risk because no new fields have been developed that can maintain the current levels of production. Exploration and production has been fostered by the government and up to now the Magallanes Basin is the only natural gas production site in Chile.

#### Gas transportation

It is possible to identify several zones in Chile in which the transportation business has been developed, 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:

##### The Magallanes Zone

The Magallanes Zone, in which a newly developed pipeline system is associated to ENAP's supplies and the industrial and residential needs of that area, mainly around the city of Punta Arenas. In addition, after the interconnection agreements with Argentina in the mid-nineties, additional infrastructure was built, namely the Bandurrias pipeline serving a big methanol development in the area. Also, 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

Here, there are two international pipelines developed by private investors and both started operations in 1999. These are Gasoducto GasAtacama and Gasoducto Norandino pipelines. They started operations, bringing natural gas from Argentina with the purpose of supplying relevant mining projects, power plants and residential customers around the city of Antofagasta. In 2000, a new local pipeline associated to Gasoducto GasAtacama was launched, the Tal-Tal pipeline, with the aim of supplying 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.

##### Central zone

This is where the biggest population and industrial developments are located. 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 a new pipeline called Gasoducto Electrogas, mainly to the city of Valparaíso. The restrictions imposed by Argentina since 2004 were also a major distress for these projects, putting them in serious financial problems.

##### Southern Chile

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

Considering the above, the transportation infrastructure in Chile is 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 have operated independently until today. That may change in the future as we will see below with the development of the LNG terminals.

#### LNG terminals

Chile has two LNG terminals. They were developed as a response to the gas restrictions of natural gas from Argentina and as a way to provide a more reliable source of natural gas.

**GNL Quintero**

Located 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 is located in Quintero Bay, it supplies Santiago and the central zone of Chile. The LNG comes from British Gas, which is 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 12 metres above the ocean that accommodates the arrival of LNG vessels and transports the element to the storage facilities and three storage facilities in land.
- three storage tanks – the first storage tank has a capacity of 14,000m<sup>3</sup> and has been in operation since June 2009. The second and third tanks have a capacity of 160,000m<sup>3</sup> each. From these tanks the LNG is transported to the regasification plant to obtain natural gas.
- a regasification plant with three vaporisers that process 2.5 million tonnes per year of LNG, producing 10 million m<sup>3</sup> of gas per day as a base and up to 15 million m<sup>3</sup> per day in peak times, which are injected into central Chile's pipeline system. The design of the plant allows up to 20 million m<sup>3</sup> per day; and
- a patio for loading trucks, which will start operating in early 2011, carrying the available capacity to supply the natural gas needs of ENAP's refinery in Talcahuano, southern Chile. The trucks will carry the LNG to a small regasification plant and later the natural gas will be transported by the existing infrastructure (Gasoducto del Pacífico and Innergy) to ENAP's plant. Any excess will supply industrial and residential needs in the Concepción area. This is an interesting development as it virtually interconnects two different zones, the central and southern systems, not by physical infrastructure but with a 20-30 truck fleet providing an equivalent function.

**GNL Mejillones**

In operation since early 2010, it 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. Initially the LNG is stored in a floating storage unit. Afterwards, the LNG goes through regasification and is transported by an 8km pipeline. The decision to build a second phase, with a land storage facility in place of the floating one, has already been made by the investors leading the project, under the supervision of GDF Suez. It will be in operation by the end of 2013.

**Natural gas distribution**

There are currently at least seven companies conducting natural gas distribution. The most relevant one 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 distribution business 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 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?

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 one varies in time. Chile has limited conventional energy sources and has a high dependence on external sources such as oil and natural gas. Historically natural gas has represented less than 10 per cent of the energy matrix.

In 1997, that situation changed because of 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 10 per cent in 2008.

The recent launch of the LNG terminals broke this trend, renewing the participation of natural gas in electricity generation, so that by the end of 2011 it is expected to rise to 30 per cent in the Central Interconnected System (SIC) and 37 per cent in the Northern Interconnected System (SING). The expectation is that LNG will play a relevant role in the energy matrix both in the SIC and SING as well as in the industrial and residential consumption of natural gas.

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

Natural gas business development 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, putting aside 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.

To introduce 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 regards 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 Complementation of 1995 between Chile and Argentina, which was a success for a few years but led to the so called 'gas crisis' with Argentina, which started in 2004 and ended with the development of LNG terminals to end dependence on Argentinian gas.

On the institutional framework, the competent agencies are:

**Ministry of Energy (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. Nowadays, it has the task of developing and coordinating the plans, policies and norms for the proper performance of the energy sector, supervising its performance and advising the government in all matters related to energy. Also, 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.

#### **National Commission of Energy (CNE)**

This 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 the companies dealing with the production, generation, transportation and distribution of energy with the purpose of having the most secure, reliable and efficient energy system.

#### **Superintendency of Electricity and Fuels (SEC)**

In accordance with its Organic Laws (Law No. 18,410 and Law No. 19,613), the SEC has the mission to supervise 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. The SEC also has a very relevant role in granting 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 CNE are the entities that determine the regulatory policies of the natural gas sector, with the SEC 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 in order to carry out exploration and production in specific gas fields. These contracts 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.

- 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 it also prescribes that exploration and exploitation can be done by the state or its companies directly or by means of administrative concessions or by CEOPs (Article 19 No. 24 CPE). The CEOPs are the standard way in which private companies, either local or foreign, may participate in the exploration and production business. The CEOPs are regulated by DFL No. 2

(Ministry of Mining) that sets the text of DL No. 1,089 of 1975. The first CEOP dates back to 1977. Another relevant statute in exploration and production is the ENAP's Organic Law (Law No. 9,618 of 1950) that 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.

Finally, it is worth mentioning that during 2007 the Ministry of Mining, at that time competent entity in this area, launched a successful International Bid Programme for exploration and production in the Magallanes Zone. It is expected that the Ministry of Energy, currently supervising this energy area, will launch a new Bid Programme for the area in which new players will be hope to conduct gas exploration and production.

#### **Regulation of natural gas pipeline transportation and storage**

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

The business of natural gas transportation is a recent development in Chile, with the exception of the Magallanes Zone, where it was developed with strong public participation lead by ENAP. Gas transportation pipelines in the central and northern zones have both the need to import natural gas for power generation and a clean energy source for industrial and residential use. They are all private initiatives, except for the minority stake ENAP has in Gasoducto del Pacífico and Innergy, in which it has about a 20 per cent stake.

As mentioned before, there are four areas or zones in which natural gas use is divided: 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. Also, the pipelines in Magallanes are the only ones transporting Chilean natural gas.

No interconnection between the zones affects direct competition in the natural gas market, in terms of the negotiation 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 fact is the high degree of vertical integration present among transportation facilities, distributors and big customers.

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

- 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.

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. In that spirit the Regulation on Definitive and Temporary Transportation and Distribution Gas Concessions (DS No. 263 of 1995) was enacted. It stipulates that the companies interested in the gas transportation business must have a definitive concession which allows them to provide the 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.

On the other hand, permanent concessions allow the concessionaire to build and operate the facility and also grants 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 it is 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, for its services in equal economic, commercial, and technical conditions regarding its available transportation capacity. Even if there is a natural monopoly, legal prescriptions prohibit the 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 (DS No. 280, (Ministry of Economy) 2009), 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 Environmental Impact Assessment approval that, at the same time, involves several administrative approvals in a complex process, which includes local community participation. There are other administrative permits that may be required, such as construction approvals and permits from competent municipalities.

- 8** 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 such as roads, rivers and water channels, among others, and also the right to impose easements over private properties, in order 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 when the concession has been 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 the easements in case of opposition from landowners. They 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 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.

- 9** 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.

The freedom of prices has been sustained by certain ideas 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

under academic discussion in the past but the original model for natural gas in Chile still remains as it was conceived in the mid-1990s.

- 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?

The Open Access rule only refers 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 in order 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 Open Access.

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

Most natural gas has come from Argentine producers, therefore the regulatory requirements applicable to the processing of natural gas to extract liquids and prepare it for pipeline transportation has been subject to those applicable norms. Notwithstanding that, Gas Transportation Agreements (GTAs) have stated quality specifications, such as in 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/m<sup>3</sup>) or the maximum higher value (10,200Kcal/m<sup>3</sup>). 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, among others. 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.

- 12** Describe the contractual regime for transportation and storage.

The natural gas market is not highly regulated and there is full freedom of contract for any participants. Concessionaires are free to sign private GTAs with any gas distributors or wholesale consumers and, at the same time, distribution companies are free to contract with industrial developers and commercial or residential customers. In fact, the SEC does not have direct access to the detail of those contracts, access that 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 capacity that has to be available at all times when transportation is needed. The client must pay for that capacity, even if he does not use it. There are firm obligations during the life of the contract (take or pay) in which the transporter must have the capacity available at all

times and the client must pay that capacity regardless of the use of it. 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 m<sup>3</sup> of gas multiplied by the maximum daily quantity (MDQ) 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, the GTAs are now taking the uncertainty of gas supply from Argentina into account. Also, GTAs have also extended the concept of force majeure and have basically only created obligations where there is gas to transport.

### Regulation of natural gas distribution

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

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

In the north, the distribution company for Antofagasta is Distri-nor, 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 controlled by Gasco. There is also a competitor for the residential and commercial segment in this area named 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 Argentinian gas crisis forced the participants in this market to invest in LNG supply to ensure a more reliable source of stock.

**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?

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 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 7).

The gas distribution business must also comply with the Regulation of Security for Transportation and Distribution of Gas, DS No. 280, the content of which was described above. Finally, the construction of the distribution system requires Environmental Impact Assessment approval, construction approval and permits from competent municipalities (see question 7).

**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?

The principle is that distribution companies are obliged to supply gas, subject to its available capacity and the security of its facilities. Generally, the 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 (TDLC), has the right to determine the tariffs for distribution companies in zones where each client, individually, has a consumption below 100Gj/month and the distribution concessionaire gets, from the existing tariff system, an economic rate of return 5 per cent superior to the rate of the annual cost of capital defined in the norms.

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.

**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?

The distribution concessionaires are obliged to provide a service to any customers within its zone of concession, in accordance with the availability and security of its 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.

**17** 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. Also, there are wholesale customers that contract directly with gas producers, in a sort of commercial by-pass, but this dynamic only works if those producers are able to use the distribution network. However, this point is debatable. The regulation is clear regarding the physical by-pass, due to the Open Access rules, however, the commercial by-pass 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 get 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, an unrestricted practice in Chile by the antitrust agencies.

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**Regulation of natural gas sales and trading**


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

As we mentioned before, 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 like 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.

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

These activities are not public services per se and therefore do not have regulatory oversight. For the same reason, they may potentially discriminate among customers with private contracts. Overall, due to 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 success. There is a loophole in the Gas Law about these entities, with a responsibility for the general obligations being the only legal standard applicable, as is in any other commercial entity doing business in Chile.

- 20** 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 and pricing at the injection point is the result of the basin price plus the processing value, adding a range of 10 to 20 per cent of transportation.

- 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.

As explained above, distribution companies and wholesale buyers deal directly with gas producers. They 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 import natural gas from Argentina, because that would require an export permit, which that government will not grant. Therefore, this market was not 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.

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**Regulation of LNG**


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

Chile currently has two LNG terminals. They exist in response to Argentina's restrictions to gas exports started in 2004.

**LNG Quintero (see question 1)**

This is a private sector project, owned by British Gas (40 per cent),

Endesa Chile (20 per cent), Metrogas (20 per cent) and ENAP (20 per cent). Currently there is a 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. 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.

**LNG Mejillones (see question 1)**

This is also a private sector project, owned by Codelco (37 per cent) and GDF Suez (63 per cent). In recent press releases, its controller has indicated a willingness to open the terminal to third parties in a kind of voluntary 'open access' regime.

- 23** 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 abandonment of LNG plants. It also includes detailed obligations for the entities involved. The SEC is the agency 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 the need for registration of the plants before the SEC, prior to its operation. In addition, the construction of LNG plants requires Environmental Impact Assessment approval, which is a complex process with the participation of local communities. There are other administrative permits required, such as construction approvals and permits from the competent municipality.

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

Like the gas market, there are no specific rules for pricing, which is subject to negotiation among the parties involved. Notwithstanding the above, 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 they are 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.

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**Mergers and competition**


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- 25** 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, among others, the gas sector. Such regulation created the Antitrust Court (TDLC) and the National Economic Prosecutor (FNE). Both are 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 the investigation of conduct that may be contrary to DL 211 and represents the public interest before the courts, especially the TDLC.

**26** 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.

Furthermore, the same article 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.

**27** 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 in an amount of up to 20,000 UTA (annual tax units) and, in the case of collusion, it may go up to 30,000 UTA.

These 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 the cooperation provided to the FNE before or during the investigation. The 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 judgement.

**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?

There are no pre-approval requirements for mergers or other changes in control. Also, there is no legal mandatory requirement to notify a priori 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 of Horizontal Concentration (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. In this regard, the FNE would consider if certain operations, that do not exceed established thresholds of concentration, are

anti-competitive. To measure the market concentration, the FNE would use the Herfindhal-Hirschman Index (HHI) and it will only carefully analyse those operations with a HHI above 1,800. Other factors will also play a role in the FNE Concentration Guide, such as the existence of barriers to entry, sunk costs and others.

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, the TDLC is always entitled to a review, at the request of a third party or the FNE, 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.

**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?

There are no tariff regulations for gas transportation, distribution or LNG in Chile. The prices for 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 need to 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 in order to determine the rate of annual capital cost, considering the systematic risk of the activities of the distribution companies in regard to its 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.

**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?

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, Chilean antitrust jurisprudence shows that market concentration is not considered anti-competitive per se 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.

**Update and trends**

The government has announced a review of the LNG market. It is not clear if this will lead to tariff regulations or Open Access rules for LNG terminals. There has been some pressure from power utilities to access the LNG facilities under the argument that they can be considered to be an essential facility. The overall question is whether the natural gas market in Chile will continue to be unregulated both in structure and tariffs.

The potential supply from Peru and Bolivia should always be in Chile's international commercial agenda. Undoubtedly any talks would

pose very difficult political questions that would need to be resolved first. A fresh commercial view is always a healthy approach to resolve old political issues.

The government has announced a second international bid for exploration and production in the Magallanes Zone during 2011. Chile lacks significant natural gas reserves and is a net importer. New companies, and potentially new technology, could improve the current situation.

**International**

- 31** 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 alternatively 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. Also, ENAP has important prerogatives in exploration and production in the natural gas sector arising from its Organic Law.

With regards 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 bylaws to the board of a company organised in accordance with Chilean laws, 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.

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

The gas interconnection with Argentina, done through the Substitutive Protocol of Protocol No. 2 of the Agreement for Economic Complementarity of 1995, was a difficult experience. As mentioned before, the interconnection worked for several years but during 2004 Argentina started to impose gas export restrictions 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 (with most of the cases 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 the contracts.

In practice, Chilean companies opted to devise a new, more reliable and secure alternative, which led to the development of the (now operating) LNG terminals. On a different experience, the recent inclusion of Chile as an OECD country has focused the authorities into renewable sources of energy and the hope is to reach 2020 with 20 per cent of the energy matrix coming from renewable sources.

- 33** 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 get 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 the past experience.

In any event, the gas now coming from Argentina is subject only to VAT (19 per cent) on the CIF value of the gas, which needs to be anticipated by a prior declaration of import (DITA), to be filed at the Customs National Service in Chile. In other words, the tax needs to be paid prior to the gas entering Chile. The control and match of what the DITA says and the amount of gas actually imported remains with the Customs National Service, backed up by a monthly report filed by transporters.

**Transactions between affiliates**

- 34** 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. On the horizontal aspect, the Gas Law indicates that the concessions do not grant monopolies, however many of them are in fact natural monopolies. There is an old ruling from the anti-trust authorities at that time, resolution 933/198 CPC dated April 28, 1995, that suggests that certain limitations to the ownership of the gas companies should be implemented in order to avoid vertical integration. To that effect, it suggested a threshold in the 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 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 and thus avoid horizontal integration in 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, there are corporate governance rules contained in the Corporate Law Act (Law No. 18,046) that provides 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.

**35** 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. Up to now, even with the degree of integration that is present in the gas sector, no such action has been filed because it will need to demonstrate a violation of the antitrust standards referred to above.

The FNE may also investigate any proposed transaction in order 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 been an argument to deter such antitrust actions or investigations until now.

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

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