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McKenzie.**

Energy, Mining and
Infrastructure

A photograph of an industrial facility, likely a refinery or chemical plant, at dusk. The sky is a deep blue with a hint of purple. In the foreground, a tall, slender smokestack on the left emits a thick, white plume of steam or smoke that drifts across the sky. To the right of the smokestack, there are several large, complex industrial structures, including distillation columns and storage tanks, illuminated by bright yellow lights. The overall scene is a mix of industrial activity and natural light.

Asia Pacific Mega-Trends and Legal Solutions

Simplifying Business in a Complex World

Energy, Mining and Infrastructure

Trends and key complexities:

Environmental policies and the shift in the regional energy mix to renewables are making the business environment exceedingly complex.

Uncertainty over energy policy enforcement and the rapid pace of regulatory change in key markets is another main concern among energy, mining and infrastructure (EMI) executives.

Lack of infrastructure in some Asian markets is creating setbacks and project losses for EMI corporations.



65%

of respondents feel doing business in the energy, mining and infrastructure sector is becoming more complex.

Asia's EMI corporations face a surge of competing challenges. Despite increases in early 2017, gains in oil prices have receded since the first quarter, causing many businesses to incur heavy losses. In other segments, while financial distress in the mining space seems to have moderated, changes in regulations are adding new complexities to the mix. The same is true in infrastructure, where a funding gap is adding to constraints.

For these reasons and others, 65% of EMI executives say business in their industry is becoming more complex, the highest percentage among respondents from the various industries in our survey. These issues, however, are

only the tip of the iceberg and respondents also highlight a series of challenges that they must now contend with to operate efficiently and profitably.

Environmental policies:

Clean and green in vogue

Environmental issues are the top concern for EMI executives as public support for renewable energy gains popularity. Indeed, the shift in the energy mix toward cleaner forms of power will prove costly for EMI corporations as they transition from traditional hydrocarbons to solar, wind, and hydro forms of power.

Respondents say this is already happening with increasing frequency, as concerns over

“ EMI companies should be engaging with the local community, and this involves a corporate social responsibility element. If the local community can see how they benefit, they are less likely to break out into civil unrest that can disrupt operations and production.”

Jo Daniels, Managing Partner, Yangon, Baker McKenzie

climate change and environmental pollution gain traction among policymakers across Asia.

Regulatory change

Hand in hand with environmental concerns, adapting to new or changing regulations is another core complexity impacting the EMI market today. It is also a decisive forward-looking priority executives will address in the year ahead, according to 86% of respondents (Figure 1).

Uncertainty over energy policy enforcement and shifting legislation is another main concern. By way of example, mining and energy players in Indonesia cited legal uncertainty as a major complexity as the government often changes its position on policy. A dispute over a major US-based mining corporation's rights to operate the world's second-largest copper mine highlights these risks and the possibility of similar challenges in other Asian markets. To reduce risk exposure, businesses need to factor in a wider buffer for unforeseen compliance costs and delays when making critical decisions on the feasibility of their endeavours.

Addressing infrastructure

Outside of Asia's advanced economies, infrastructure, or lack thereof, can often create unexpected setbacks to operations

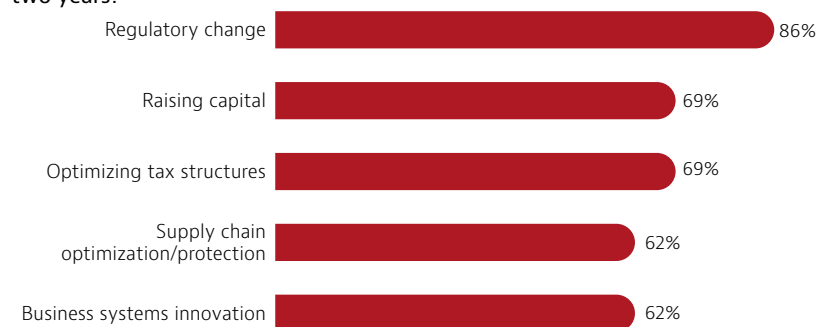
and access to raw materials. Among those in our survey, many highlight unexpected increases in costs associated with bridging infrastructure gaps. Others note that insufficient infrastructure – from drilling and transportation of oil to mining and managing the excavation process – heavily impacted their project returns.

As one solution to this, one respondent points out that consolidation within the industry could help EMI businesses reduce costs. Such collaboration could better position EMI corporations to share resources and infrastructure, efforts that could prove beneficial to reducing pressure on their financial performance.

“Energy companies often need advice on labor laws, regulatory issues such as licensing and ongoing compliance, as well as land laws. At the very least, an ignorance of the rules – both written and unwritten – can raise the cost of compliance through penalties, legal and social disputes can frustrate business operations, while delays in paperwork can hike up outlay costs through longer production lead times.”

Bee Chun Boo, Partner, Beijing, Baker McKenzie

Figure 1: Which areas do you think will be a major focus for your industry in the next two years?



Steps for success: Regulatory foresight, local insight

Rising environmental awareness and activism are among the biggest issues facing EMI corporations. Baker McKenzie's **Bee Chun Boo** and **Jo Daniels** delve into solutions for addressing the compliance and regulatory complexities for EMI corporations.

Engage local stakeholders

Social unrest and populist movements are becoming an unavoidable part of business in parts of emerging Asia. EMI corporations can engage with stakeholders in the local community as part of outreach efforts to illustrate the social and economic benefits of certain projects and business deals. Managing this process is best accomplished with a boots-on-the-ground approach in which relationships with local business and political leaders are forged to create an understanding between parties.

Act accordingly: Know the law of the land

To limit risk exposure, EMI corporations need to educate themselves on the regulatory nuances of local markets and seek to open a dialogue with local authorities. Businesses also need to build in expectations for a longer lead-time when it comes to securing government approvals. Furthermore, EMI corporations should consult local advisors on issues from tax compliance to environmental approvals to help them understand local laws and the enforcement landscape where laws and ordinances lack detail and clarity.

Abide by higher standards

When it comes to compliance and anti-corruption standards, most EMI multinationals will know the requirements of laws from their home jurisdictions, such as the US Foreign Corrupt Practices Act (FCPA). The challenge they face is whether they can still carry out their businesses efficiently and legitimately in investment destinations in Asia Pacific. Equally, the FCPA and other foreign legal guidelines stipulate that foreign businesses may face some consequences if their local suppliers and contractors are not fully compliant, even if these business partners are not familiar with these laws. To minimize risk exposure, corporations need to set up a strong compliance framework and train their staff to follow a comprehensive code of conduct.

Plan for the unexpected

Natural disasters and social unrest are outside a corporation's control, however, having a comprehensive business interruption plan can help manage the risks of these events. This includes insurance against heavy costs from disrupted supply chains and business processes and holds true when forging partnerships with local businesses: EMI corporations need to ensure their counterparties are adequately covered and have similar plans for worst-case scenarios.





Industry insights: Powering the future

After a protracted period of low oil prices, the EMI sector is seeing an urgent need to reassess their energy mix and leverage emerging technologies to find solutions to power the future.

Mike Thomas, Partner and Co-Founder of Lantau Group, discusses policy, operational and technological questions for corporations looking to correct course.

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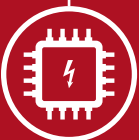


Energy players that find policy support in the changing energy mix will stay relevant

EMI corporations should regularly ask where their offerings fit in the regional and global energy mix, and where there is more robust policy support. Policy uncertainty is one of the more challenging strategy variables. Then it becomes a matter of assessing the value of their portfolios and plotting a direction to steer investments.

Given falling costs and improving performance, traditional energy players should prepare for a market swing towards renewables. The tipping point may be indeterminate, so timing may be the most challenging variable. Few Asian countries have consistent or supportive renewable energy policies despite growing awareness and interest, though Malaysia and Taiwan bear promise.

2



Tech disruption will offer opportunities for electricity system flexibility

The hidden value behind disruption in EMI lies in opportunities for electricity system flexibility. When new technology is adopted and throws things out of balance, corporations should recognize that this represents an opportunity for a market for demand-side and supply-side flexible responses. Such responses could include battery storage and ancillary service revenue streams.

Industry players can also leverage disruptive technologies for more subtle applications in asset management and efficiency. Advanced metering technologies offer options to electrify emerging markets while reducing non-technical losses, with ways to use information to optimize maintenance, enhance service and improve revenue collection. In the Philippines, Meralco is transforming its network into a smarter grid via Advanced Metering Infrastructure (AMI) and other technologies.

3



Energy players who plan for change will lower stranded cost exposure for legacy assets

Industry stakeholders need to think about what potential regulatory change and technological inflection mean for the value in existing or legacy assets in terms of stranded cost exposure. Power purchase agreements (PPAs) offer some protection, but as legacy generation assets reach the end of their PPAs, investors should consider whether they need to be decommissioned or if they can be re-contracted. Investors buying assets that face post-PPA regulatory exposure must factor that into their bid price. They should also consider whether regulatory change has transitional safeguards for stranded cost recovery, and whether the change is likely to trigger unintended consequences, such as a degradation of the security of supply.

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