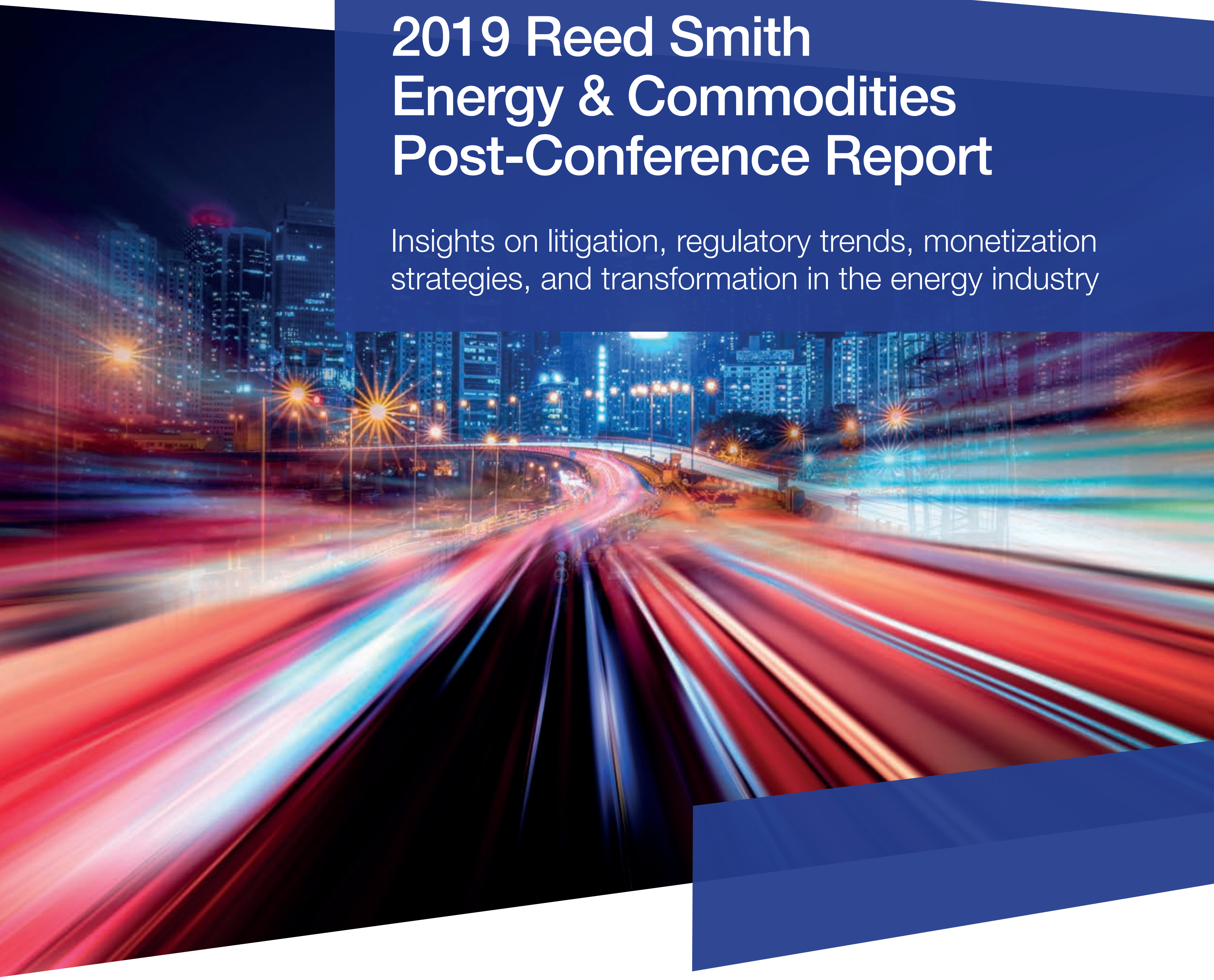
December 2019

2019 Reed Smith Energy & Commodities Post-Conference Report

Insights on litigation, regulatory trends, monetization strategies, and transformation in the energy industry



ReedSmith

Driving progress through partnership

Contents

Greetings

Dear friend, client, colleague:

On October 10, 2019, the fifth annual Energy and Commodities Conference was held at the Marriott Marquis in Houston, Texas. Following this event, we are delighted to share our first post-conference report with you.

For the last five years, this conference has brought us together for a day of lively and informative panel discussions and networking about energy and commodities law and business. We purposefully designed our conference around you, our friends and clients. Our goal is to provide a forum that examines the latest legal and commercial developments in the sector, and helps you connect with your peers and the Reed Smith lawyers with whom you work. The conference also offers continuing legal education (CLE) credit in most U.S. jurisdictions, which we know is important to you. We are delighted that clients continue to view this event as an excellent resource.

We would like to thank our clients and colleagues for sharing the time and legal insight that went into planning this conference. It takes a lot of hard work to develop clear-eyed analysis that is relevant and enlightening for senior lawyers. So, for the first time, we have worked to prepare and curate a number of short articles on each panel to share with you, so a wider audience can benefit from the sessions.

As you will see, the panels addressed a number of topics, including regulatory developments, litigation trends, inventory monetization, responses to industrial accidents, development and finance for renewable energy, practical blockchain applications in energy transactions, in-house counsel issues, and more. Several common themes emerged, including the impact of geopolitical volatility on energy and commodities markets, emerging new technology that is improving and disrupting the industry, the world's transition toward a decarbonized future, the rise of alternative finance models for energy transactions, managing an energy company's reputation, and keeping up with changing U.S. regulatory priorities. Through discussions at the networking sessions and in the Q&A, we noticed the continued growth in prominence of cybersecurity and data privacy of customers, with issues quickly coming to bear in the marketplace and in courts.

It will be interesting to see how these themes play out as we move into 2020. Indeed, we already have started planning the 2020 conference, which will showcase insights from our lawyers in Texas, including our newest office, Dallas, and from other members of our global energy and commodities team. We would love to hear your ideas for topics you would like to hear explained in 2020.

About the Energy and Commodities Conference

Reed Smith's annual Energy and Commodities Conference offers legal insight into recent developments, challenges, and opportunities facing global and domestic energy and commodities markets. The fifth annual conference was held on October 10, 2019 in Houston, Texas, providing a complimentary day of legal education for friends and clients of the firm. To register your interest for the 2020 conference, please contact Clare Seabourne at cseabourne@reedsmith.com

Facts & figures

5th annual conference

6 panel sessions, plus a keynote speaker and an ethics session

CLE credit, including ethics, in **more than 20 jurisdictions** across the United States

20+ speakers

more than **150** attendees

Reed Smith's annual Energy and Commodities Conference is all about connections. We connect with our colleagues in other offices and practice groups, and we connect with our clients. We enjoy the time spent with our friends and clients, and take the opportunity to discuss important trends and issues that are on the minds and desks of our clients.

Stefanie Burt
Partner and conference chair
Pittsburgh

I have had the privilege of serving on the planning committee for two years, and my clients have indicated to me that in the Houston energy market, our conference is one of the best events in the market.

Edwin Nazario
Counsel and conference chair
Washington, D.C.

The conference provides our clients with an opportunity to discuss topics of interest to them and to shape the industry thinking about such topics.

Craig Enochs
Partner and conference chair
Houston

Federal and state energy regulatory roundup

Takeaways

- It is important to keep an eye on FERC composition as the Commissioners are front and center in docket and policy decisions.
- FERC will establish a new regional Houston office, through a new division in its Office of Energy Projects.
- FERC is modernizing its regulations governing small power producers and co-generators under PURPA.

What's happening at the Federal Energy Regulatory Commission (FERC)? Who's there? Who's leaving? How are they thinking? What are they doing? Colette Honorable, a partner in Reed Smith's Washington office, discussed recent developments and key takeaways from the past year of FERC activity.

FERC nominations/commissioner updates

The White House recently announced its intention to nominate current FERC General Counsel James Danly to serve as the fourth FERC Commissioner, although no nomination date has been set. On the other hand, former FERC Chairman Cheryl LaFleur concluded her term in June 2019. With LaFleur's departure, the Commission is currently left with three out of five sitting Commissioners: Chairman Neil Chatterjee (term expires June 2021) and Commissioners Richard Glick (term expires June 2022) and Bernard McNamee (term expires June 2020).

Commissioner McNamee came to the Commission after serving in a number of roles which included representing a number of clients that were very active in the FERC space, resulting in a number of recusals. Similarly, Commissioner Glick has received guidance on ethical matters from FERC staff that will cause him to have to recuse from certain dockets until late November 2019. It is important to pay attention to this because the lack of quorum due to recusals is causing delays in certain FERC dockets, Honorable said.

FERC Houston office

In July 2019, Chairman Chatterjee announced that FERC would establish a new regional Houston office, through a new division in its Office of Energy Projects. The office is a result of the ramp up in LNG projects and the consequent growth in LNG project applications, with much of that work happening in Houston. Chairman Chatterjee also announced that some of the policy functions that have traditionally been in the Office of Enforcement, will now be moving to other places in the agency, primarily the Office of Energy Policy and Innovation.

RTO/ISO update

Transmission planning challenges: From an Order 1000 perspective, interesting debate is happening with regard to how Order 890 is implemented.

Order 1000 is a July 2011 FERC final rule that addresses coordination of transmission planning and cost allocation obligations for new electricity transmission capacity.

Order 890, an earlier FERC final rule, requires more transparency of available transfer capability used in determining prices. It tells transmission owners in a regional context, how they should be focused on transmission planning projects with regard to supplemental projects.

Right now FERC is challenged with whether to allow transmission owners to focus on asset management, which would allow them to do their own planning without going through the Order 1000 planning process or whether they have to work through the RTO/ISO process, she said.

Reliability-must-run issues: On the west coast, FERC recently allowed the California ISO to treat certain gas plants as reliability-must-run assets that would ordinarily retire due to being uneconomic. We are seeing this trend not only with gas, but also nuclear generation; and not only in California, but in other places around the country. This is interesting, especially because FERC has now given the California ISO the authority to treat those assets as reliability-must-run assets to keep them going. Commissioner Glick, who dissented from this FERC decision, is concerned that it gives the California ISO unchecked authority, without review by the Commission.

Fair Rates Act Statements: In 2018, Congress passed the Fair Rates Act Statements, which pertains to matters under the Federal Power Act. Under the Federal Rates Act statements, if the Commission cannot vote on a matter due to a lack of quorum, each one of the Commissioners must issue a statement in the record stating their views on the matter. The law went into effect this year and we have seen now three filings with individual statements filed by the Commissioners.

Project updates

There has been a significant increase in pipeline certification dockets. Not only the pipeline dockets, but there is also a dramatic increase in LNG terminal application dockets and the associated projects that support the facilities, as well as the associated rate makings that flow from all of the above.

There are a number of dockets awaiting Commission action, which impacts construction deadlines, capacity commitments and ultimately end-use customers.

The greenhouse gas emissions debate

Arguments abound over how FERC must demonstrate that it has analyzed indirect impacts of greenhouse gas emissions in project applications under the Natural Gas Act. The National Environmental Policy Act (NEPA) requires this analysis, and we have seen an interesting evolution of authority from the courts. In *Birckhead v. FERC* (2019), the D.C. Circuit decided that FERC should "at least attempt to obtain the information necessary to fulfill its statutory responsibilities." This approach differs from the June 2017 Council on Environmental Quality's proposed guidance on this matter, under which FERC should use the "rule of reason" in its analysis of greenhouse gas emissions, according to Honorable.

PURPA modernization

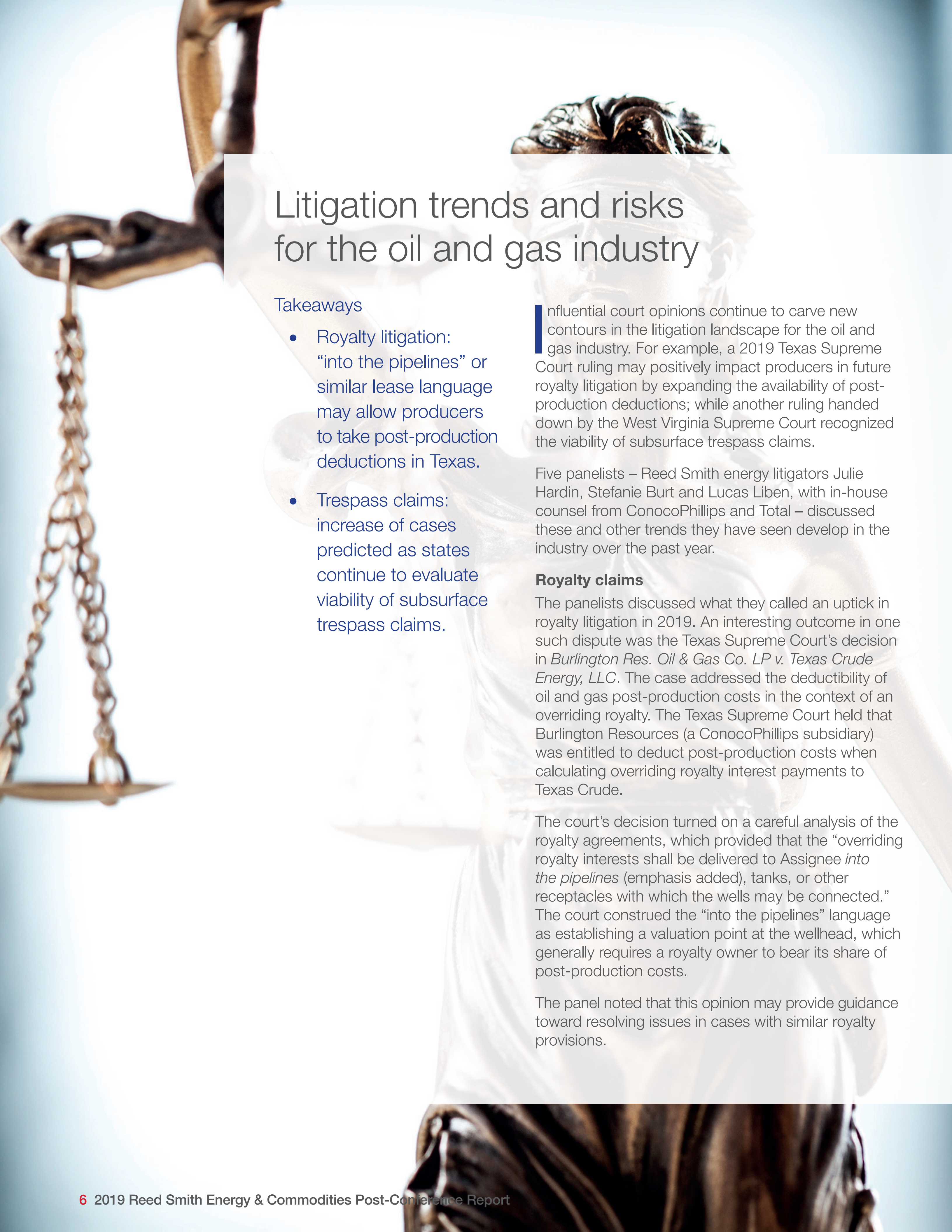
FERC recently announced it is modernizing its regulations governing small power producers and co-generators under the Public Utility Regulatory Policies Act of 1978 (PURPA). The key PURPA reforms proposed by FERC are: (i) state authorities can develop "as-available" Qualifying Facility (QF) energy rates based on market factors; (ii) utilities in states with retail choice programs are relieved from the QF purchase obligation; (iii) a flexible one-mile rule (which defines tightly clustered facilities as one facility); (iv) to reduce the rebuttable presumption regarding participation in organized wholesale markets for small power production facilities from 20 MW to 1 MW; (v) that QFs must demonstrate commercial viability and be supported by suitable financial commitments; and (vi) a reformed QF certification process.

Speaker:

Colette D. Honorable
Partner, Washington, D.C.

Author:

Diego Perez Terry
Associate, Houston



Litigation trends and risks for the oil and gas industry

Takeaways

- Royalty litigation: "into the pipelines" or similar lease language may allow producers to take post-production deductions in Texas.
- Trespass claims: increase of cases predicted as states continue to evaluate viability of subsurface trespass claims.

Influential court opinions continue to carve new contours in the litigation landscape for the oil and gas industry. For example, a 2019 Texas Supreme Court ruling may positively impact producers in future royalty litigation by expanding the availability of post-production deductions; while another ruling handed down by the West Virginia Supreme Court recognized the viability of subsurface trespass claims.

Five panelists – Reed Smith energy litigators Julie Hardin, Stefanie Burt and Lucas Liben, with in-house counsel from ConocoPhillips and Total – discussed these and other trends they have seen develop in the industry over the past year.

Royalty claims

The panelists discussed what they called an uptick in royalty litigation in 2019. An interesting outcome in one such dispute was the Texas Supreme Court's decision in *Burlington Res. Oil & Gas Co. LP v. Texas Crude Energy, LLC*. The case addressed the deductibility of oil and gas post-production costs in the context of an overriding royalty. The Texas Supreme Court held that Burlington Resources (a ConocoPhillips subsidiary) was entitled to deduct post-production costs when calculating overriding royalty interest payments to Texas Crude.

The court's decision turned on a careful analysis of the royalty agreements, which provided that the "overriding royalty interests shall be delivered to Assignee *into the pipelines* (emphasis added), tanks, or other receptacles with which the wells may be connected." The court construed the "into the pipelines" language as establishing a valuation point at the wellhead, which generally requires a royalty owner to bear its share of post-production costs.

The panel noted that this opinion may provide guidance toward resolving issues in cases with similar royalty provisions.

Warranty claims

The panelists also saw an increase in litigation involving breach of warranty claims. Breach of warranty claims in the oil and gas industry require significant resources to litigate due to the technical expertise and testing required to establish or defend against allegations that a product is not fit for its intended application.

The panel noted that the risk allocation that parties agree to in their contracts will invariably control a party's claim over any injustice that may result. In light of this reality, parties asserting or defending against warranty claims must first identify and determine what terms and conditions govern the parties' relationship. The outcome of this "battle of the forms" can often mean the difference between a US$100 million recovery and a US$1 million recovery, as limitation of liability provisions as well as disclaimers of consequential damages have become commonplace.

Consequently, the panelists identified ways by which parties can increase the likelihood that favorable terms will govern their dispute, including: (1) negotiating frame agreements (such as master services agreements) to cover as many relationships as possible; (2) forcing counterparties to actually sign the parties' standard terms and conditions (if unable to negotiate a frame agreement); (3) training employees to expressly reject a counterparty's terms in writing; and (4) specifying and limiting employees with authority to bind the company to different or amended terms.

Trespass claims

Lastly, the panelists discussed various trespass claims in 2019. First, the panel highlighted the Supreme Court of Appeals of West Virginia, in *EQT Prod. Co. v. Crowder*, upheld a finding of trespass when a severed surface estate had been utilized to develop the oil and gas beneath that surface conjointly with oil and gas from neighboring tracts. The panel also discussed the Pennsylvania Superior Court's decision in *Briggs v. Southwestern Energy Production Co.*, in which the court held that a claim for subsurface trespass may be maintained as a result of hydraulic fracturing, and that the "rule of capture" does not preclude the cause of action. The decision in *Briggs* was a split from the Texas Supreme Court's decision in *Coastal Oil & Gas Corp. v. Garza Energy Trust*, which precluded such a claim. The panel noted that the industry is watching to see what Pennsylvania's highest court will now do with the matter.

Speakers:

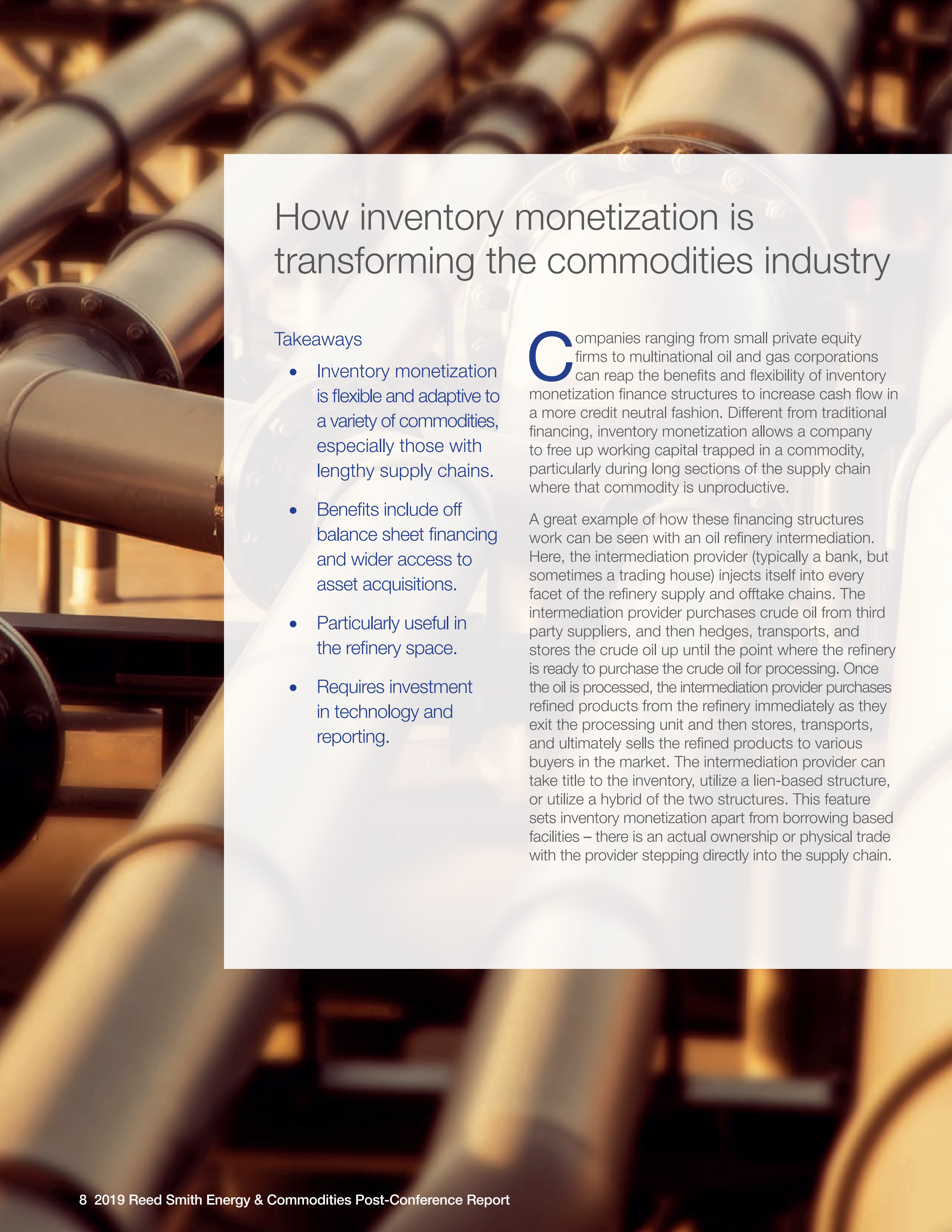
Julie A. Hardin
Partner, Houston

Stefanie L. Burt
Partner, Pittsburgh

Luke Liben
Partner, Pittsburgh

Author:

Heriberto R. Montalvo
Associate, Houston



How inventory monetization is transforming the commodities industry

Takeaways

- Inventory monetization is flexible and adaptive to a variety of commodities, especially those with lengthy supply chains.
- Benefits include off balance sheet financing and wider access to asset acquisitions.
- Particularly useful in the refinery space.
- Requires investment in technology and reporting.

Companies ranging from small private equity firms to multinational oil and gas corporations can reap the benefits and flexibility of inventory monetization finance structures to increase cash flow in a more credit neutral fashion. Different from traditional financing, inventory monetization allows a company to free up working capital trapped in a commodity, particularly during long sections of the supply chain where that commodity is unproductive.

A great example of how these financing structures work can be seen with an oil refinery intermediation. Here, the intermediation provider (typically a bank, but sometimes a trading house) injects itself into every facet of the refinery supply and offtake chains. The intermediation provider purchases crude oil from third party suppliers, and then hedges, transports, and stores the crude oil up until the point where the refinery is ready to purchase the crude oil for processing. Once the oil is processed, the intermediation provider purchases refined products from the refinery immediately as they exit the processing unit and then stores, transports, and ultimately sells the refined products to various buyers in the market. The intermediation provider can take title to the inventory, utilize a lien-based structure, or utilize a hybrid of the two structures. This feature sets inventory monetization apart from borrowing based facilities – there is an actual ownership or physical trade with the provider stepping directly into the supply chain.

The advantages to this alternative financing structure are numerous. Primarily, this structure is flexible and can be scaled easily to fit any size transaction. This structure can also be flexible as commodity prices move over time. Additionally, the amount of cash released for the user can be significantly greater than traditional financing, while also removing market risk. With refinery intermediations, hedging is undertaken by the intermediation provider as the owner of the inventory.

At the Reed Smith Energy and Commodities Conference in Houston on October 10, 2019, Tariq Remtulla, Parkland's senior legal counsel and assistant corporate secretary, told attendees that inventory monetization allowed Parkland Fuel Corporation to reduce its senior secured debt and instead apply off balance sheet treatment to a significant volume of inventory, thereby significantly reducing the publicly traded fuel supplier's debt ratio and freeing up cash for other acquisitions.

Eric Kaufman, founder of Republic Square LLC, highlighted a key advantage for smaller buyers. Speaking from the private equity perspective, he said inventory monetization can allow a company to leverage a counterparty's expertise, credit, trading relationships, and risk management in order to purchase assets in a space that is higher risk and that was previously inaccessible to small private equity buyers. Inventory monetization may allow for advance rates upwards of 90 percent, perhaps even up to 100 percent, Kaufman added.

Mitch Fowler, director of structured commodities origination at ICBC Standard Bank Plc, highlighted key advantages from a banking standpoint. Specifically, the bank is able to provide physical liquidity without creating markets in a particular location, which would act to compete with clients. The benefits of inventory monetization for users derive mostly from the fact that the provider will assume entire sections of the supply chain and capital structure, removing significant risk for the user, Fowler emphasized.

However, Remtulla, Kaufman, and Fowler all cautioned that this is an ongoing and interactive relationship between user and the intermediation provider, which means that users need to choose wisely when selecting their intermediation partner. The structure, while powerful, is complex and involves quite a steep learning curve. For many users, technology and reporting are keys to better management of these structures. Remtulla recommended partnering with legal advisors and firms that have significant experience with these particular types of transaction, referencing his company's choice of Kirsten Polyansky and Reed Smith. Ms. Polyansky also praised these alternative financing structures as incredibly "robust and dynamic," adding that while they are incredibly complex, she has "never met a commodity [she] couldn't monetize."

Speaker:

Kirsten S. Polyansky
Partner, Houston

Author:

Carrie C. Gorner
Associate, Houston

Keynote: How geopolitics and markets are shaping the move to a decarbonized future

Takeaways

- The U.S. shale boom faces some notable hurdles with the 2020 election approaching and a challenging energy policy environment – both at the state level and in the courts.
- As climate policy moves ahead without President Donald Trump – and pretty much all but a handful of national governments – environmental, social, and governance investors are helping to fill the void.
- The natural gas industry's position as a winner in the energy transition is not secure, and new strategies are needed for competing and winning amid global decarbonization.

Everyone would agree that geopolitics affect global energy markets. But what is not getting enough attention is the increasing and even disruptive role of geopolitics in the energy transition, with key factors being next year's U.S. election, spreading populism, and a so-called G-Zero world that is characterized by a growing vacuum of global governance. Robert Johnston, executive advisor and managing director of Global Energy and Natural Resources at Eurasia Group, talked about the political environment of the energy transition at Reed Smith's fifth Annual Energy and Commodities Conference in Houston.

In the United States, the proliferation of shale oil and gas production faces energy policy headwinds from a range of political, regulatory, and social sources. At present, most of the major Democratic presidential candidates are in favor of aggressive action on climate policy, a strategy that could run against the recent populist tide. Senator Bernie Sanders boldly plans to invest US$16 trillion in the Green New Deal, which outlines a pathway to 100 percent renewable energy in the next decade. Sanders is also committed to removing federal subsidies for fossil fuel production and banning detrimental fracking. Similarly, Senator Elizabeth Warren supports the Green New Deal, and she has pledged to stop new fossil fuel drilling on public lands and in public waters if she is elected.

A Democratic president would pose considerable challenges to U.S. oil and gas production from shale. The U.S. midstream energy sector has already been hit by state and local governments' attempts to block not only new pipeline projects but also expansion of existing pipelines and their gathering and storage infrastructure. Similarly, in Canada, Enbridge Inc.'s Northern Gateway Pipeline project was met with heavy opposition from indigenous groups and ultimately cancelled.

Will energy remain relatively free of the hyper-polarization and dysfunction dominating the regulatory and policy debate? Or will the country enter a new era with energy and climate taking center stage again in Washington? The 2020 election is a key watch point.

ESG investors fill the gaps

As climate policy moves ahead without Trump, environmental, social, and governance (ESG) investors are helping fill the void. ESG investment has been gaining momentum over the past decade, with shareholders having a stronger influence than governments on climate action. At present, more than 30 percent of the world's investable assets – about US$30 trillion worth – include ESG considerations in investment decisions. In the U.S. market, a total of US$12 trillion is directly linked to an ESG mandate, marking a 20-fold increase between 2010 and 2018. Of the US$12 trillion in assets, US$3 trillion is tied to climate and carbon objectives.

Divestment from fossil fuels is also on the rise. In 2018, nearly 1,000 institutional investors with more than US$6 trillion of assets have pledged to divest from fossil fuels globally. This year, Norway's sovereign wealth fund, fearing "a permanent oil price decline," announced it is divesting US$7.5 billion of oil shares.

At the same time that ESG investment efforts are increasingly notable in energy markets, investors are debating whether and when oil industry assets will become stranded. According to this trend, low-cost producers that are efficient, have scale, and whose countries are politically stable will benefit. In contrast, countries that are highly dependent on oil and have low political capacity, such as Venezuela, will suffer the most.

Dimmer views of natural gas

Within the global energy transition, natural gas had long been considered a low-carbon "bridge" fuel to cleaner sources of energy. Recently, however, its position as a winner in the transition is no longer secure, as the industry has come under scrutiny by environmentalists for issues such as its greenhouse gas (GHG) impact and fracking-related health and environmental concerns. In the United States, the "war on coal" appears to have broadened to a "war on fossil fuels" among the Democratic base. Moreover, Carbon Tracker Initiative, an influential NGO and data provider, suggests that "a company cannot be Paris-aligned if it sanctions non-Paris-aligned projects."

New strategies are therefore needed in the natural gas sector for competing and winning amid global decarbonization. Liquefied natural gas (LNG) companies are encouraged to reconsider their project design, as the next wave of final investment decisions will likely favor not just the cheapest but also the cleanest and most secure. In addition, worsening air quality in emerging Asia may incentivize countries to enact policies that accelerate coal-to-gas switching, similar to what China has been doing over the past few years.

There have been discussions, meanwhile, about using Article 6 of the Paris agreement to help "lock in" fuel switching. Under Article 6, participating countries can "pursue voluntary cooperation" to combat climate change through internationally transferable mitigation outcomes (ITMOs) and can have GHG reductions booked equally between them.

This rationale could provide opportunities for natural gas. Canada is suggesting using ITMOs for the LNG Canada project in British Columbia, which would enable coal-to-gas switching, reduce emissions, and allow buyer and seller to share the economic value of the ITMO. While Article 6 still requires finalization and approval at the 2019 UN Climate Change Conference in Madrid, the ITMO model helps level the playing field for LNG projects with stricter GHG standards and policy environments to compete with more CO_2-intensive but lower-cost LNG and coal sources.

Speaker:

Robert Johnston
Managing Director, Global Energy and Natural Resources for Eurasia Group

Contributor:

Ramy A. Morad
Associate, Dallas

Voted off the island: When in-house counsel can’t represent an individual employee

Takeaways

- In-house attorneys must exercise heightened care when interviewing employees in internal corporate investigations.
- Internal investigations can reveal individual culpability.
- Courts and bar associations are moving towards distinct ethical guidelines for in-house attorneys.

Internal investigations – particularly those with the potential for criminal exposure – force in-house counsel into a difficult position that they must tactfully finesse or else risk legal and professional consequences. Tom Allen, Reed Smith’s general counsel, used the high-profile Jerry Sandusky/Penn State investigation as a cautionary tale of the ethical issues that may arise during internal inquiries. Allen also discussed recent developments that may bring some new protections to in-house lawyers.

While it may seem simple enough that an in-house attorney represents the company and not its employees, in practice this can present real problems for both employees and lawyers. Although communications between company counsel and company employees are protected by attorney-client privilege, it is the company – not the employee – that holds the privilege. As such, the company may waive the privilege and disclose employee communications should it be in the interest of the company.

Legal problems specific to the energy field may include retail pricing misconduct, stock-price manipulation, anti-competitive behavior, providing unsafe products or services, research misconduct, fraudulent accounting, conflicts of interest, performing services when unqualified, violating others’ IP rights, and violating the confidentiality and privacy of client and consumer data.

If accused of any of these issues, the organization looks at what happened, when problems started, and who knew about them. During that process, the company may find isolated individuals were behind the improper behavior, representations, or relationships. This may force the firm to separate itself from the bad actor in order to limit its own liability and achieve a more favorable resolution. It might actually need to help the government (or plaintiff) build its case to reduce its ultimate liability and avoid penalties. That might require throwing somebody under the proverbial bus.

So, when interviewing employees about misconduct, best practice dictates that company counsel should provide an *Upjohn* warning (named for the influential 1981 case heard by the U.S. Supreme Court) to employees about the lack of an attorney-client relationship. Specifically, the lawyer should warn the employee that: (1) the company does not represent him or her individually; (2) the lawyer will report information gleaned from the employee to others at the company; (3) the employee must keep the contents of the interview confidential; and (4) the company may disclose the information the employee provides to the government.

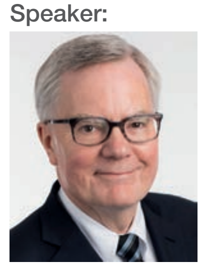
Should an issue later arise, the employee may claim that he or she believed the company counsel represented them, leading to problems for the lawyer, including claims of inadequate representation. Therefore, the lawyer needs to be clear about the warning and should seek to document its contents and when it was provided. However, this in turn raises another issue: a written or heavy-handed warning might spook the employee and reduce their willingness to cooperate in candor. One potential solution is for the lawyer to provide an oral warning, but document it in a memo after the interview. An in-house attorney should not advise an employee whether to retain their own counsel as the employee may later use this advice as a basis to assert representation by the attorney. Another alternative – depending on the facts of the case – is for the lawyer to undertake a multiple representation, and represent both the company and the employee. But the lawyer must follow the rules of professional conduct and be wary of any conflicts of interest or other facts that may arise to materially limit their ability to adequately represent both the company and the employee. The lawyer must always think ahead toward the end of the investigation, because actions in the present may have effects down the road. The lawyer should be particularly conscious of any potential conflict between the position of the company and the position of the employee. If this conflict materializes, the lawyer must end the multiple representation.

The recent Penn State case offers an example of the problems that may arise in this area. There the university's counsel was tasked with investigating the allegations against Jerry Sandusky, a former football coach, and the potential cover-up by university personnel. The counsel worked with a former employee of the university as part of the investigation, and appeared with the former employee before a grand jury. The attorney also testified before a grand jury regarding unproduced documents, and gave testimony that led to additional charges against the former employee. The former employee moved to suppress the testimony of the lawyer as a breach of privilege. The appellate court found that the counsel was representing the former employee, did so inadequately, and breached her privilege obligations—and so suppressed the lawyer's testimony. State bar disciplinary proceedings were also commenced against the lawyer. This case illustrates the importance of adequate *Upjohn* warnings and the why in-house lawyers must exercise great care in determine whether to undertake multiple representation.

Other developments may have an impact on the rules governing in-house lawyers:

1. The Supreme Court of Washington recently held in *Karstetter v. King County Corrections Guild* that despite the general rule that a client may fire his or her attorney for any reason, employment and wrongful discharge laws apply to in-house counsel.
2. The D.C. Bar Association is considering rules to limit a client's ability to require an over-broad engagement agreement. In particular, the Association is looking at provisions which redefine conflicts, impose indemnification requirements, or assert ownership and control over attorney work product.
3. The New York City Bar Association has recently offered an opinion potentially increasing what a lawyer may do with inadvertently produced material to balance the competing interests of protecting a client from fallout from a lawyer's mistake while ensuring the recipient-client of full representation.

Speaker:



Thomas L. Allen
Partner, Pittsburgh

Author:

Mason W. Malpass
Associate, Houston

What's the worst that could happen?

The harsh and unpredictable realities of major industrial incidents

Takeaways

- Increased media scrutiny and agency jurisdiction may be causing an increase in the criminalization of major industrial incidents.
- Enforcement actions are now focusing equally – if not more so – on a company's response rather than just on the facts leading to a major incident.
- Companies can protect themselves by developing incident response plans that anticipate litigation and insurance recovery claims.

At Reed Smith's Energy and Commodities Conference, a panel of in-house and law firm attorneys discussed the challenging and unpredictable aspects of responding to major industrial incidents, such as oil spills, explosions and fires, chemical exposures, and damage caused by natural disasters like Hurricane Harvey.

Media attention

Panelists described instances where the drumbeat of media attention has influenced civil and criminal enforcement and increased resource requirements for companies.

Sensationalized media coverage can spur more regulatory scrutiny, a combination that may result in increased response costs for companies, according to a senior legal counsel for a large energy corporation.

Media involvement varies depending on location, the in-house attorney noted. An incident near a California urban center may require more resources than if the same incident occurred in a rural area in the Southeast, she said.

Agency enforcement

Panelists also noted how the large number of agencies that may assert jurisdiction in investigating a major accident will add complexity to the company's legal response.

For example, even where the U.S. Chemical Safety Board (CSB) had not established jurisdiction over one company's refinery release, the agency stressed to the media that it was trying to get to the bottom of the incident but was being prevented, increasing pressure on the company. In that situation, the company had to decide if the potential damage to its reputation was worth fighting the CSB's bid for jurisdiction.

Increased criminalization

A number of environmental laws have always carried the threat of criminal penalties. However, criminal prosecutions of companies and individuals for alleged environmental violations are increasing. Additionally, the decision to investigate and prosecute incidents as criminal is happening rapidly—sometimes within 24 hours of the incident.

Another in-house attorney panelist at a U.S. pipeline-focused company, described the company's response to a pipeline release in Santa Barbara where prosecutors obtained a grand jury subpoena for documents within a day of the spill. In the end, the company and individual employees were indicted on 46 criminal counts.

Panelists also noted the increased focus on criminalizing a company's response actions rather than the facts leading to the actual incident itself. The pipeline executive noted that response activities may implicate process crimes, which can be easier to prove. For example, the energy industry has recently seen prosecutions for perjury, spoliation, and destruction of evidence.

Protecting your company

The panelists identified several ways companies can seek to protect themselves from significant liability following an incident.

Anticipate litigation and insurance recovery claims

Incident response plans should include provisions anticipating litigation and insurance recovery. The first priority in responding to a major incident should always be protecting human life and the environment. Considering litigation and insurance recovery as early as possible in the response can provide a strategic advantage.

Put the company's insurers on notice and involve them in how it is responding to the incident.

Protect privilege

Non-lawyers at companies often do not understand how attorney-client privilege and attorney-work product doctrine apply in the context of a major incident response, or they apply these critical tools too late.

In order to afford as much protection as allowed, educate your employees on the mechanics of attorney-client privilege, the work-product doctrine, and the legal department as a whole. Involve legal early in the process of audits and incident responses.

Develop plans with both legal and insurance considerations

Conduct risk assessments and assign teams that can respond should an incident occur. Develop a plan covering all eventualities, including: (1) who will take charge in the event of an incident; (2) what level of response is activated depending on which incident; (3) who is in charge of notifying whom; and (4) whether the company will be using outside consultants or experts.

Develop an effective communications plan

Sophisticated companies are expected to respond to the inquiries of media and other stakeholders in the context of a major incident.

Prior to the frenzy of an incident response, develop a media plan detailing how you will deal with the press. The panelists discussed establishing dedicated websites, pre-approved holding statements, local versus national coverage, and the role that social media accounts play during the incident response.

Speakers:

Benjamin H. Patton
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Trends in development and finance of renewable energy projects

Takeaways

- Credits and subsidies' significance as project drivers is diminishing.
- Demand at corporate and state levels will drive growth.

With United States coal generating capacity down nearly 40% since 2008, and wind and solar generation at nearly record levels, renewable industry players are optimistic about the future.

Brendan McNallen, a partner in Reed Smith's San Francisco office, David Berry, the chief financial officer of ConnectGen LLC, and Cary Kottler, vice president of North American development for Pattern Energy, discussed several trends in financing and development of renewable energy projects. Specifically, the panelists focused on issues of supply, storage, transmission, and demand in the renewables industry.

Mandates' impact hard to detect

Twenty-nine out of 50 U.S. states have enacted renewable portfolio standards (RPS) that require a specified percentage of the electricity that utilities sell to come from renewable resources, with some states requiring as much as 100% in upcoming decades. These were enacted to prompt utilities into diversifying their energy mix and to reducing carbon emissions. According to Berkley Labs, nearly half of all growth in U.S. renewable electricity capacity since 2000 is associated with state RPS requirements.

That said, the panelists questioned whether RPS requirements have been the real driver of the increased renewable supplies in the United States. While state RPS requirements have functioned to offset diminishing federal standards, economic factors like the diminishing costs to construct wind and solar projects versus the increasing expense of operating coal plants have likely done more to set the stage for growth in the renewable sector, they said.

Diminishing tax credits and subsidies

Federal tax credits, however, will continue to play a role in driving renewable capacity, but the clock is ticking on that.

Two important U.S. renewable energy generation incentive programs are phasing out, specifically the federal Production Tax Credit (PTC) and Investment Tax Credit (ITC).

The phase-out of PTC for projects that begin construction after December 31, 2019, has caused concern among many players in the renewables sector. Wind energy projects that start construction after the phase-out date will no longer be eligible for the credit.

In the meantime, wind facilities that begin construction on or prior to December 31, 2019 can obtain some level of PTC provided they complete the project in 48 months, with those projects beginning construction during calendar years 2016 and 2017 eligible to claim 100% and 80%, respectively, of the PTC amount. For that reason, the years 2020 and 2021 are expected to be exceptionally busy construction years, as builders scramble to finish projects that qualify for 100% or 80% of the PTC.

The ITCs are based on a percentage of the cost of building new renewable energy generation. The Solar Energy Industries Association attributes a major boost in annual solar growth to the ITC. This too will see a phase-out, albeit partial, with the credit for commercial and utility-scale solar projects being reduced from 30 percent in 2019 to 10 percent by 2022. Developers that commence construction before December 31, 2021 may still qualify for a higher ITC if projects go online on or before December 31, 2023.

Another factor that may dampen renewable construction and generation is the uncertainty caused by U.S. tariffs on Chinese solar panels, the speakers said.

But despite all this, renewable energy projects continue to enjoy support at the corporate and state level, and stakeholders and energy consumers are increasingly demanding renewable energy, the speakers indicated. The likelihood of the introduction of steeper pollution penalties on carbon-based energy production also suggests a boon for renewable projects.

Drivers for storage and transmission

Technological limitations are holding back bulk energy storage for wind and solar projects, in spite of innovations in storage technology, the speakers said. Although some in the industry expected declines in cost of lithium ion batteries to make storage a more viable alternative, their drop in price remains insufficient to make bulk storage viable. However, the recent extreme electricity price spikes during summer months is likely to spark continued innovation to accommodate the elasticity in demand.

Transmission projects continue to face both economic and regulatory hurdles. Utilities are facing increasing pressure to address aging infrastructure such as transmission lines, but conflicting geographical interests make them reticent to do so. For instance, solar panels are typically constructed close to urban areas and thus do not require extensive transmission projects, while wind projects, which are ideal candidates for transmission due to their typical distance from urban areas, are challenging to entitle.

Similarly, interstate transmission projects have greater upside than intrastate projects, but steep regulatory burdens make them intimidating prospects for utilities. Balancing these conflicting geographic and regulatory issues will remain of primary importance for wind and solar developers.

Tech industries may drive development for branding reasons

Although demand has plateaued over the past decade, demand for energy in the computer processing industries has increased dramatically. This industry looks increasingly to renewable energy to repair the damage to brands caused by early reliance on carbon-based fuels.

Additionally, renewable energy projects remain a very promising investment opportunity in developing countries all over the world, the speakers noted.

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Blockchain promises efficiencies for the energy and shipping industries

Takeaways

- Blockchain advantages: supply chain management; faster transactions, recordkeeping.
- Strong potential to generate savings and profits for energy and shipping companies.
- Best applied to value-chain problems that benefit from decentralized solutions.
- Authorization, privacy, and regulatory compliance require special attention.

Energy industry players are increasingly and actively looking at blockchain solutions as the next emerging technology to spur growth in the energy sector. It's not hard to see why. With its smart contracts and systems interoperability, blockchain offers unique solutions for energy markets and distribution channels.

Christine T. Parker, a partner working for Reed Smith in New York, and Kate Shirey, a senior manager for energy resources and industrials at Deloitte & Touche in Houston, gave a few examples.

1. Distributed ledgers and smart contracts can facilitate near instantaneous execution and clearing of energy derivatives and automate margining.
2. Blockchain technology can streamline regulatory reporting and recordkeeping obligations.
3. Crypto tokens backed by physical energy resources could monetize reserves of commodities lying dormant in storage.
4. Crypto token credits could become the means of compensating consumers who sell excess energy back into the grid.
5. Renewable energy or carbon-trading credits can be issued as crypto tokens.

The shipping business – still highly dependent on paper-intensive transactions – likewise could benefit greatly from blockchain. Parties along the supply chain using blockchain could upload and share documents instantaneously and securely. Every participant could track and manage a shipment's progress and documentation from end to end, eliminating administrative delays and reducing costs.

In addition to real-time updates and eliminating delays associated with paper chain, other benefits include blockchain's tamper-resistance, increased security, lowered transaction costs, and decreased transaction and settlement times.

Smart contracts can add value

A smart contract contains terms turned into encoded if/then conditionals.

1. Because the contract is programmed to automatically execute after its terms have been fulfilled, it is less likely to be breached, for example, through human error.
2. A smart contract can bypass the many tedious steps a transaction must go through in the clearing and settlement processes. So, a higher volume of transactions can be efficiently completed at a faster rate.
3. Transparency and user accountability are heightened because the record on a blockchain cannot be changed.

In spite of these many benefits, Parker and Shirey said, blockchain technology requires users to understand and account for its limitations and risks, such as difficulty correcting errors and some vulnerability to fraud.

A blockchain is not an enterprise database – it is a specific transaction, Shirey said. It is important that businesses ensure this open source technology is used only for areas that will benefit from or require decentralization. Further, businesses must have access to proper resources to both invest in new technology and address eventualities caused by the new technology. Commercial entities need to ensure that the process savings will justify the expenditure to put blockchain in place. For certain companies, non-blockchain technology, such as advanced analytics or robotics, may offer better solutions at greater value.

After all, setting up a blockchain often requires companies to take special precautions to address privacy and cybersecurity issues. For example, organizations that host blockchains open to outside participants to verify transactions must carefully consider and address the possibility of hacking attacks. So, risk assessment and risk management are imperative for entities considering blockchain technology. Legal issues like confidentiality agreements, non-competes, and who has rights to the intellectual property generated by the blockchain are also significant issues that must be carefully addressed.

Blockchain technology is optimal when parties in a value chain to come together to solve a problem that lends itself to a decentralized solution. It is most successful when the parties form ties with partners they already know and work with, as a blockchain's success often centers on trust, Parker and Shirey said.

Blockchain is a tremendously helpful key for specific problems identified by parties who are comfortable with the technology and able to conduct proper risk assessment and management. A successful blockchain captures these key elements in a value chain when parties create a smart contract and a plan for data security and intelligent use of intellectual property.

While not a panacea, blockchain presents exciting opportunities in how we store and share information securely online. Furthermore, the use of blockchain technology is growing in prevalence and sophistication in the energy industry. The opportunities for blockchain solutions go beyond the energy trading floor, Parker and Shirey noted. Blockchain technology can yield smooth transactions that significantly increase back-office and middle-office efficiencies. It can solve quality control, logistics, and supply chain problems. The opportunity is wide open for innovators to apply blockchain across the digital landscape.

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