



Outlook: Spring 2022 **Energy & Commodities**

Trends, challenges
and regulatory changes

Introduction

The last months have been ominous for the people and economies of the world. With the war in Ukraine, the world economy is at a risk of becoming as fragmented as it was during Cold War days, and the energy sector is first in line for disruption as more markets look for ways to avoid purchasing energy from Russia.

The geopolitical breakdown is putting a strain on the transition to carbon-free energy, as hydrocarbon production must ramp up to stabilize prices in the face of the Ukraine war. Private equity investors continue to favor energy innovation and renewables, as they steer their investments toward more environmental, social and governance (ESG) ends. The response to COVID-19 and the abatement of that pandemic has triggered inflation, and spurred energy consumption, but another of the pandemic's legacy is an expansion of litigation for nonperformance of contracts.

This report, which details the topics discussed at our flagship Energy & Commodities Conference, gives you an updated picture of a rapidly evolving situation, and makes clear: We are seeing new kinds of litigation and expect this situation to produce even newer kinds of unforeseen litigation. We invite you to reach out to any of our authors to discuss the issues we address and what they mean for your organization.

Geopolitical instability



Ukraine war reshapes energy geopolitics and decarbonization

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Geopolitical instability



Ukraine war reshapes energy geopolitics and decarbonization

Takeaways

- Russia's aggression is causing Europe to relook elsewhere for gas imports
- Opportunities open up for LNG exporters
- Boycotts might speed up adoption of renewables

Russia's invasion of Ukraine is a watershed geopolitical event, the impact of which will be felt for years if not decades. Although the war is just over two months old, its fallout is reshaping the contours of international relations. The foundations of the post-Cold War security architecture in Europe have been upended, U.S.-Russia relations have entered a new period of enmity and distrust, divisions between China and the West have widened, financial flows have been disrupted, and trade patterns are being altered. These far-reaching impacts are pulling down global economic growth and driving up inflation. With Moscow showing no signs of retreating, and the risk that sanctions will become more stifling, the eventual economic impact could be greater and longer lasting.

The energy sector is also feeling the shock. The most apparent energy impact is the spike in oil and gas prices, as a combination of self-sanctioning, supply concerns, and uncertainty over possible future trade restrictions have driven up prices and led to unprecedented levels of volatility. With the war still ongoing, and growing pressure on European states to formally sanction imports of Russian energy, high prices and volatility are likely to be a feature of markets for some time to come.

A new energy world is emerging

But the impact of the war will be felt beyond prices. The conflict is prompting structural shifts in energy flows, investment, and consumption patterns that will have a lasting impact on the sector and alter geopolitical balances in the process.

Changes in gas flows are one of the most evident signs of these developments. Europe's newly found determination to decouple from Russian pipeline gas will not only create new markets for LNG; it will also force Moscow to look for new buyers for the gas that is displaced, with China likely to take a large proportion of any surplus. The switch cannot happen overnight: It will require new pipeline infrastructure that will take time to build and cost tens of billions of dollars. But the long-term effect will be to erode Moscow's political influence both west and east, as Europe's gas dependency on Russia is reduced, and the importance of the Chinese market increases for Russian companies that lack other outlets for their commodity.

This shift also illustrates how LNG is altering gas-market dynamics and the politics of this energy source. Gas markets have traditionally been regional, constrained by the geography of pipelines. However, the flexibility and marketability of LNG compared to pipeline gas give the fuel a fungibility more akin to crude oil, with flows now able to be redirected to meet demand. This has given consumers and policy-makers in Europe options that they





Perhaps the most profound long-term impact of the crisis will be its effect on the pace of energy transitions.

have not previously had to diversify their gas supplies, again altering political balances in the process. True, this diversification comes at a higher cost, but the political and energy-security benefits are deemed to outweigh the increased price burden, in the short term at least.

The politics of oil is also changing in significant ways. For the first time since the 1970s, consumer nations have become swing producers in oil markets, using their strategic reserves to replace lost barrels and to influence prices in the short term. Since late November 2021, the United States and other International Energy Agency member states have pledged to release a total of 350 million barrels in a bid to ease high prices. By contrast, OPEC – which traditionally has played this swing role (and jealously guarded its prerogative to do so) – stuck to its July 2021 quota agreement, promising incremental increases of 400,000 barrels per month (although delivering significantly less due to production constraints).

OPEC has prioritized medium-term concerns over fundamentals, and its policies – or at least those of Saudi Arabia, its most influential member – also have been shaped by political animus toward Washington. But in doing so, Riyadh and its allies have squandered the credibility of their commitment to being the producer of last resort, while also allowing a new precedent to be set by consuming states, which may henceforth continue to intervene actively in physical markets based on price concerns, thereby undermining OPEC's market-management effectiveness.

Energy transitions and energy security become more intertwined

But perhaps the most profound long-term impact of the crisis will be its effect on the pace of energy transitions globally, and on divergences in the speed of decarbonization and emission reduction between different regions of the world. In Europe, heightened energy-security concerns prompted by the Ukraine war have supercharged plans to expand the share of renewables in the energy mix, and to improve energy efficiency. This is the first major crisis of the energy-transitions era, and the availability of alternatives to hydrocarbons gives policy-makers new response options. The EU's already ambitious green-transitions targets for 2030 will be brought forward to mid-decade where possible, and the region will become a laboratory for what is possible when political intent, the energy-security imperative, public support, and finance align.

Outside of the EU, the crisis might not propel decarbonization as much. European countries' focus on LNG to provide a medium-term bridge between Russian gas and renewables will drive the cost of the fuel up in the medium term, making it prohibitively expensive for developing states that wanted liquefied gas to replace coal. China is already showing early signs of this impact, with Beijing re-prioritizing coal production and consumption, and temporarily eliminating intensity and emissions targets, as it seeks to protect its own energy

and economic security. China remains wedded to capping emissions and transitioning its energy use in the longer term, but while LNG prices remain uncompetitively high, and it lacks sufficient renewables capacity to take up the slack, it will not jeopardize economic growth targets for decarbonization ones.

A similar pattern is likely to be witnessed elsewhere in Asia and in Latin America, with high LNG costs disrupting immediate energy-transitions plans. But high LNG prices will not necessarily prohibit energy transition altogether. Instead, they could encourage some countries to leapfrog directly to renewables, rather than transitioning through gas first. Much will depend on whether the investment for this transformation becomes available at affordable costs, with private-sector financial institutions set to play a determining role. If capital is made available for investment, some developing countries could follow Europe's example and accelerate their decarbonization efforts, rather than being left behind. What is certain is that the next decade will be transformational for global efforts to achieve net-zero carbon emissions targets by mid-century.





About the author

Raad Alkadiri is managing director for energy, climate, and resources at Eurasia Group. He focuses his work on the nexus between politics, economics, climate, and the energy sector, as well as its effects on market behavior and investment risk. He works closely with clients to advise on capital-allocation options, risk-mitigation strategies, and policymaking. He also closely follows medium- and long-term geopolitical, energy, and climate trends, and their impact on the risk environment.

Raad has more than 25 years of experience advising senior executives and government leaders. He came to Eurasia Group in 2021 from BCG, where he was a senior director in the Center for Energy Impact, focusing on country dynamics. Prior to that, he was managing director for petroleum sector risk at IHS and a partner and head of markets and country strategies at PFC Energy. In 2003-2004, Raad served as assistant private secretary to the UK Special Representative in Iraq, and in 2006-2007, he was senior political adviser to the UK Ambassador in Iraq. He holds a doctorate in international relations from the University of Oxford. He also holds a master's degree in international relations and a first-class honors degree in psychology and international relations from the University of St Andrews.



Energy transitions



What opportunities does private equity see in the energy and commodities transition?

Takeaways

- Private equity firms focus increasingly on clean energy transition projects
- Hydrocarbon consumption, however, is not expected to abate in the next five to 10 years
- PE investors help traditional energy companies as they diversify into cleaner sources
- Countries need to be energy independent and secure in light of geopolitical events

For some time, private equity (PE) firms have focused on investments in the traditional energy sector. This usually involved investing in oil and gas companies that extracted crude oil and produced refined petroleum products. In recent times, however, PE firm investors have shifted their focus from traditional fossil fuels-based businesses to energy transition companies that focus on clean energy and renewables. Does this signal a fundamental and permanent shift for PE investment away from traditional fossil fuels-based businesses? Also, how does the PE sector view traditional energy companies and their move into cleaner and greener spaces? We take a look at these questions through the PE lens.

Current fundraising landscape, for traditional and for clean energy

Starting in the early 2000s, PE has generally had a relatively easy time raising capital for oil and gas projects. More recently, however, PE firms have increasingly focused more investment into energy transition companies with a focus on industrial decarbonization, clean energy and renewables. One reason for a shift in focus is the low rates of returns over the last 10 years from traditional

energy investments. Also, the public is demanding more carbon reductions in a bid to protect the atmosphere and reduce human influence on climate change. For example, pension and endowment funds are less willing to invest sizeable equity into the traditional energy space. Some would argue that clean and renewable energy companies have outperformed both listed fossil fuel companies and public equity market indices in recent years, and with lower volatility.

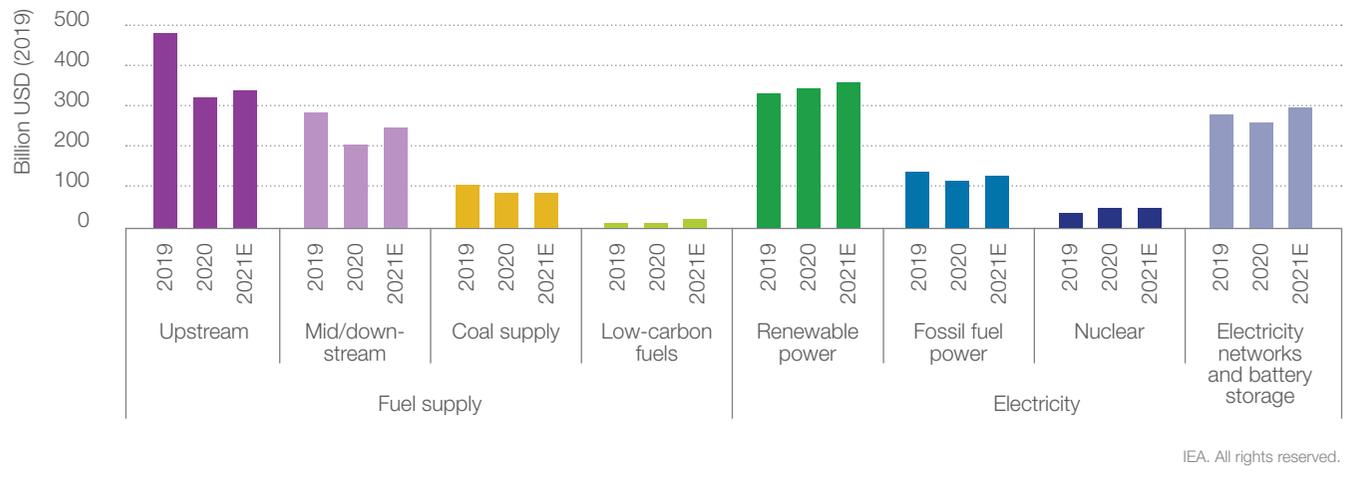
The chart (see next page), obtained from the International Energy Agency (IEA), shows a decline in capital investment in traditional oil and gas sectors, and an increase of investment in renewable power and electricity networks and battery storage.

The IEA says more governments, companies and financial institutions are making commitments to achieve net zero emissions by 2050 or soon thereafter.





Global energy supply investment by sector



Current approach to capital raising in the energy sector

According to James Wang, managing director of Ara Partners, the issue of capital allocation by PE firms in the energy sector appears to be LP specific. On one end of the spectrum, some LPs want none of their investments to be in fossil fuels-based businesses, whereas other LPs believe in an incremental shift away from fossil fuels to investments in industrial decarbonization businesses such as hydrogen blending and renewable competing alternatives.

Wang commented on the historical return rates of traditional energy plays. Over the last 10 years, the return on investment in the traditional energy space has not been encouraging, especially taking into consideration steady, low gas prices (barring the impact of recent world events in hiking prices). In making their investment decisions, LPs not only look at the ESG policies and goals of the businesses, but also their potential return on investment.

Unintended consequences in the green energy sector

Despite the many benefits of clean energy and renewables, the energy transition sector faces its own challenges and unintended consequences, which cannot be ignored. For instance, transitioning from gas powered to electric vehicles results in a proliferation of lithium ion batteries, increasing waste, and creates issues around how such waste is disposed. In addition, electric vehicles will put a strain on power grids as a whole and are less effective in times of natural disasters such as floods and hurricanes.

Future of fossil fuel extraction and consumption

According to David Finan, a partner at EIV Capital, there is a strong likelihood that five to 10 years from now, the world will be consuming more hydrocarbons – not fewer – because developing countries around the world are far behind developed countries in terms of readiness to move away from fossil fuels. For instance, he stated that picking the bottom 30% of the global population over the next decade, and trying to raise the standard of living for this population to that of a country such as Mexico, would increase global energy consumption by 40%. Finan also stated that the energy intensity of the developing world would have an increased impact on global energy consumption and emissions. Thus, the transition to cleaner, green and renewable energy on a global scale will likely take a much longer period than anticipated.





Private equity firms can help traditional energy companies make incremental improvements in the transition to cleaner forms of energy.

Areas of opportunity for PE investors in energy transitions

When investing, PE firms should look to make not only incremental changes, but also practical changes. Wang provided several examples. One example for Wang's firm is to invest in reducing and eliminating waste through recycling plastics. Another area of opportunity he sees is in the recycling of lithium ion batteries, which are used to power various devices, including smart phones and electric vehicles. Also, PE firms are investing in processes that turn waste to value by converting waste plastic feedstock to post-consumer products that trade at a premium. Finan also gave an example of how his firm is investing in feedstock substitutions by substituting methane derivative products with ethanol.

PE's role in energy transition

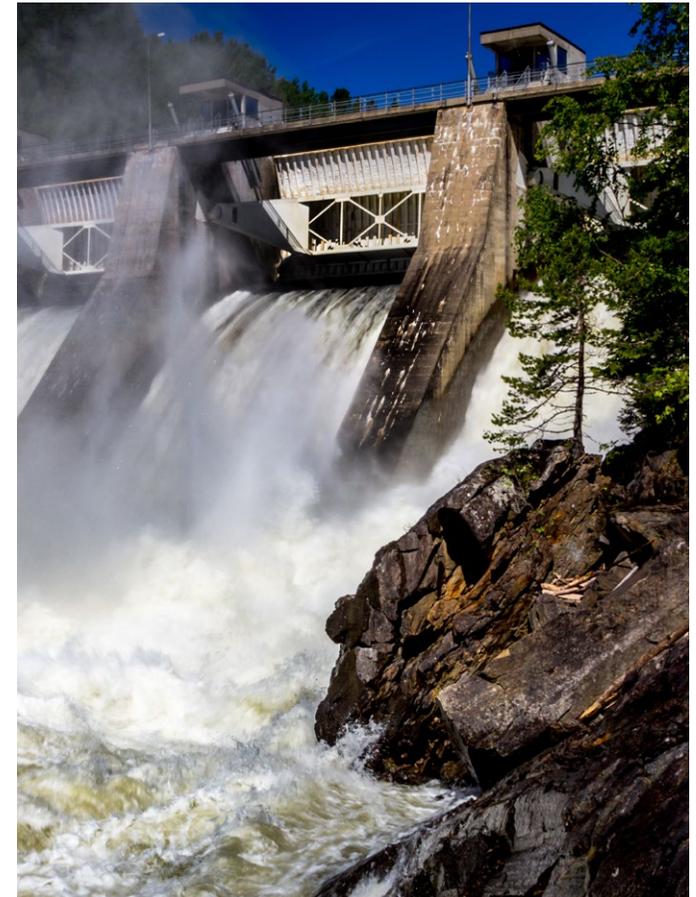
PE firms can play a very important role when it comes to the transition from traditional to cleaner forms of energy. PE firms may have the ability to assist traditional energy companies in making incremental improvements to help decarbonization efforts.

They understand that traditional energy companies trying to making significant investments in non-fossil fuel-based businesses can be hampered, given that traditional energy companies are generally not set up to experiment with new technologies or processes outside their core business of fossil fuels extraction and production.

Finan also mentioned the fact that the valuation expectations at energy transition companies are much higher in comparison to traditional energy companies, which trade at a much lower level. If traditional energy companies partner with PE firms, this can create comfort for companies to dabble in the renewable energy sector. PE firms are often better equipped to evaluate early-stage companies through due diligence and organizational management, which can help those companies grow and become viable investments for traditional energy companies.

Impact of recent world events on carbon fuels

The current rise in inflation is a problem for new energy as costs of raw materials have gone up. Also, the Russia-Ukraine crisis has highlighted the importance of energy security as a national security concern for the United States and other large, western economies. In the future, countries will be less willing to rely on unstable regimes as their sole or primary source of energy. This creates an incentive to invest in both transitional energy and traditional energy in order to ensure energy security and independence.





About the authors

Efren Acosta has a broad based M&A practice, representing private and public clients, including private equity firms, in mergers, acquisitions, joint ventures, and other transactional matters across a variety of industry sectors, including the energy sector. Efren has substantial cross-border M&A experience, with a particular focus on Latin America. His experience extends to representation of both U.S. and Latin American clients in mergers, acquisitions, joint ventures, and other matters in the region.

Kirsten S. Polyansky has a broad commodities transaction practice, representing energy companies, trading houses, private equity firms, and global financial institutions. Kirsten's range of commodity coverage includes crude, refined products, NGLs, LPGs, renewables, metals, agricultural products, and credits, as well as the physical (e.g., long-term supply and offtake arrangements, storage and transportation via pipe, vessel, rail, and truck) and financial trading of same. Kirsten's practice also focuses on large-scale structured transactions involving inventory monetization, intermediation, and true sale arrangements for refineries and storage and pipeline positions.

Ron J. Scharnberg advises clients on a wide range of federal tax matters, with particular emphasis on the federal tax planning and structuring of domestic and cross-border/international mergers and acquisitions, tax-free reorganizations, spin-offs and divestitures, joint ventures and partnerships, and restructurings. He has experience in connection with upstream, downstream, midstream, and other energy and energy-transition-related acquisitions, dispositions, joint ventures, tax equity, and tax partnerships, and the Section 45Q tax credit for carbon capture and sequestration.

Kunle Uthman represents clients in commodity and derivative transactions, with a focus on energy transactions. His experience includes advising on mergers and acquisitions, private equity, oil and gas, and complex real estate transactions. He has also worked on structured finance arrangements related to inventory monetization and a number of structured wholesale and retail power and gas transactions, including transportation agreements, exchange agreements, and storage agreements.



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Worldwide coordination: The key to success on achieving carbon neutrality

Takeaways

- The transition to a carbon-neutral economy will require energy producers, policymakers, and customers to coordinate market developments
- A clear regulatory framework is required to support infrastructure investments
- The energy transition is a great opportunity, and a global imperative, which will require an “all-tools-in-the-box” approach to be successful

Carbon-neutral initiatives: The view from Europe, the United States and Asia

As the driving force behind the energy transition, Europe seeks to become the first continent to achieve carbon neutrality by 2050. The European Commission has released the “Fit for 55” package to facilitate the green transition. It includes stricter regulations and emissions standards for industry, carbon pricing and related taxes, as well as rules to promote investment in low-carbon fuels, technologies and infrastructure. In parallel, the European Union is developing a Carbon Border Adjustment Mechanism, which is expected to come into effect in 2023. Under the CBAM, importers will be required to pay for carbon-intensive products imported into the European Union, to ensure carbon emissions embedded in imported goods are taxed equally, as compared to similar products produced within the European Union.

In the United States, the Biden administration has likewise made reduction of carbon emissions a key pillar of its overall policy. On the first day of his presidency, President Joseph Biden brought the United States back into the Paris Agreement, a legally binding international treaty on climate change. He issued executive orders establishing a task force to improve the government’s sustainability

efforts and creating a plan to achieve a carbon pollution-free electricity sector by no later than 2035. The executive orders have also sought to curb carbon-intensive power (e.g., coal, oil and natural gas) projects abroad. In addition to the executive actions, he has championed two large spending bills that include substantial incentives for renewable energy and carbon emissions reductions.

Energy-efficient countries in Asia, such as Japan and South Korea, have also set ambitious goals to further reduce greenhouse gas (GHG) emissions by 2030 and achieve carbon neutrality by 2050. Indonesia and Singapore have similarly agreed to implement bold clean energy initiatives. However, perhaps most significantly, China, one of the largest global consumers of energy, has announced its plans to reach peak emissions by 2030 and carbon neutrality by 2060. China, like South Korea, has prioritized hydrogen as an emerging industry, aiming to have 5 percent of China’s energy consumption met by hydrogen by 2030.





Massive ramp-up required

Achieving a smooth and cost-effective energy transition will require an “all-tools-in-the box” approach, including an increase in liquefied natural gas (LNG) to support and underpin the transition to a renewables and hydrogen based economy. To successfully navigate the energy transition, producers, policymakers and customers will need to move in step, which will require global cooperation, consistent policy development and regulatory frameworks to provide the certainty required for investments to build the necessary energy infrastructure. Like anything in its infancy, the opportunities are great but so are the risks, due to the regulatory and policy uncertainty.

Russia’s invasion of Ukraine and its impact on the global energy transition

Before the Russian invasion of Ukraine, global energy markets were already supply constrained due to the steady reopening of markets following the lifting of COVID-19 restrictions. Energy prices were becoming unsustainably high and rising. The Russian invasion has exacerbated the situation, with significant further increases in LNG and gas prices, which have now decoupled from equivalent crude oil prices. It is a troubling scenario.

Global LNG markets do not seem to have any spare capacity, which could be used to displace Russian gas supplies to Europe. To increase LNG supplies to Europe will require the diversion of supplies from other markets, primarily Northeast Asia and Indo-Asia. As a result, the focus in Europe in the short term will likely be on securing spot or short-term quantities which are uncontracted, before then seeking to secure long-term future supplies from Africa and the United States. In turn, as we have seen recently with Russian crude oil sales, Russian gas and LNG in the future may be diverted to Asian markets, potentially at a discount.

LNG’s role in the energy transition

LNG will have an essential role to play in the global energy transition, displacing coal and fuel oils in the power generation mix and providing the necessary reliability to underpin the expansion of renewable power generation. However, there are notable risks:

- a. Certain jurisdictions lack clarity on their long-term plans to use gas and LNG in their domestic energy mix. Often, time periods for the planned transition to a hydrogen or renewable energy economy are reduced, which can fundamentally alter the planned return on investment for gas and LNG infrastructure. Policymakers must, therefore, give clear and consistent signals to enable the energy industry to make the investments required in necessary new infrastructure.
- b. In the absence of clear regulatory guidance, final investment decisions for LNG infrastructure projects may slow, leading to further supply-side constraints in the market. In turn, LNG/gas prices are likely to remain unsustainably high, potentially forcing end customers to turn back to coal for power production, which is arguably the worst possible outcome from an environmental standpoint.





Renewable energy accounts for 10 percent of energy generation globally, and will need to get closer to 65 percent or 70 percent in order to achieve carbon neutrality by 2050.

Renewables' role in the energy transition

Renewable energy has been a consistent and effective force in the transition away from carbon-based fuels for over a decade. Global investment in the low-carbon energy transition has more than doubled since 2010. Solar energy, offshore wind and battery energy storage, in particular, have led this surge in the last couple of years.

These investments have impacted both the global power mix and overall GHG emissions. In the United States alone, there has been a steady rise in renewable energy and a decline in the contribution of coal to the overall energy mix since 2005 – coal, once the dominant fuel, now contributes roughly the same share as each of nuclear power and renewables. At the same time, there has been an increase in natural gas-fired power, a lower-emitting fuel than coal, which is the largest contributor to the U.S. energy mix. In conjunction with these changes, carbon dioxide emissions from energy consumption in the United States have declined consistently since 2007.

While investment has been significant over the past decade, renewable energy still only accounts for 10 percent of energy generation globally, and will need to get closer to 65 percent or 70 percent of global energy generation in order to achieve carbon neutrality by 2050. Such a lofty objective will require governments to maintain consistent and robust incentives to encourage renewable energy deployment and “price” the cost of carbon into new energy projects. As for the United States, the federal government and regulators will need to find ways to accelerate the new-build transmission from renewable energy-rich parts of the country to more densely populated areas.

Hydrogen's role in the energy transition

In addition to the use of hydrogen in fuel cells, technology is being developed to increase the proportion of hydrogen that can be used in gas-fired turbines. There have been a number of successful pilot projects, including in the United Kingdom and the Netherlands, which have demonstrated the potential of using existing natural gas infrastructure to transport hydrogen blended with natural gas. However, hydrogen is not the same as natural gas. Hydrogen is the lightest and smallest chemical element, which results in higher leakage rates. Also, hydrogen is highly combustible and corrosive, which presents obvious challenges.

In addition, as hydrogen has a low volumetric energy density, finding the most efficient means of long-distance transportation can be challenging. Conversion to ammonia has attractions, but the process results in significant energy losses.

To produce green hydrogen also requires significant quantities of water. As the majority of green hydrogen projects are planned for construction in jurisdictions with high temperatures and limited water resources, such as Australia, the Middle East, and North Africa, concerns arise over the volume of water needed. While solutions to secure and preserve appropriate water supplies exist, including utilizing desalination or reverse osmosis plants, these raise concerns as to the “green” credentials of such hydrogen sources.

Moving forward, we anticipate there will be a significant focus on the “hydrogen rainbow.” Despite “hydrogen being hydrogen” from a use perspective, for end customers, there will be a strong focus on the “type” of hydrogen being supplied in order to meet ESG commitments, regulatory reporting requirements, and possible carbon border taxes. As a result, there will be a heightened focus on the verification and certification of hydrogen production and potentially bespoke liability regimes to reflect the particular requirements of end customers.





About the authors

James Atkin advises companies in the oil & gas, energy and infrastructure sectors with their international energy investments. Widely recognized as a leading energy lawyer with a Band-1 ranking from *Chambers Global*, James advises clients in the energy sector on transactions in Asia, Australia, Europe, the Middle East, Africa and North America. He also has extensive experience advising on large-scale energy projects, LNG sales arrangements, and energy-related mergers and acquisitions. In *Chambers UK 2021*, James was described as “very knowledgeable of the industry, very easy to work with and very efficient.”

Brendan M. McNallen is a partner in the Energy & Natural Resources Group. His practice focuses on project development and finance in the energy generation, energy storage, transmission and distribution, and infrastructure sectors, with a specific focus on renewable energy. He represents developers, owners, manufacturers, and lenders in the development, supply, construction, and financing of onshore wind, offshore wind, solar, and battery energy storage projects. Brendan also represents utilities in the procurement and construction of transmission and distribution facilities, procurement programs, and program management activities. He has advised on energy projects throughout the United States and around the world, including Europe, South America, the Middle East, Mexico, and Canada.

Emma L. Short focuses her practice on litigating intellectual property matters across a broad range of industries, including the energy industry. She has experience in a range of technologies, including patents involving the distribution and customization of computer applications, as well as patents where she is able to utilize her background in biochemistry. In addition to her intellectual property practice, Emma has experience litigating general commercial disputes and mass tort litigation in state and federal courts.



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Regulatory enforcement update



SEC policy shift expected to increase power of shareholders moving for action on ESG

Takeaways

- Policies that thwarted shareholder ESG proposals reversed
- New policies protecting socially responsible initiatives are being implemented
- Broad-scope issues like climate change may be included alongside core business activity
- Concept of shareholder micromanagement narrowed

With proxy season in full swing, the U.S. Security and Exchange Commission's new view of shareholder proposals could significantly bolster environmental, social and governance (ESG) causes that shareholders want to promote.

SEC's newer approach to reviewing shareholder proposals will make it harder for companies to block shareholder initiatives, including ones to reduce carbon emissions and promote social responsibility.

It is important for businesses to understand this SEC policy shift, even as they continue to learn about the proposed climate disclosure rule, which we discussed ([Scope 3 emissions](#) and for [Scope 1 and 2 emissions](#)) last month.

Earlier policy discouraged activism

SEC rule 14a-8 (17 C.F.R. § 240.14a-8) relates to shareholder proposals. Under rule 14a-8, a company must include shareholder proposals on its proxy statement for consideration at annual and special meetings. Under certain circumstances, however, rule 14a-8 provides that a company may exclude a shareholder proposal from the proxy statement. Two common exclusions that companies rely on to exclude shareholder proposals are the ordinary business exclusion in section 240.14a-8(i)(7) and the economic relevance exclusion in section 240.14a-8(i)(5).

Under the Trump administration, the SEC issued a series of bulletins relating to the interpretation of the ordinary business and economic relevance exclusions. The guidance in the bulletins effectively imposed restrictions on shareholder proposals aimed at influencing corporate strategies related to broad social issues like climate change and corporate responsibility. The SEC at the time said the restrictions were intended to safeguard against shareholder micromanagement and ensure that proposals were economically relevant to the company's business. Therefore, the SEC focused on the nexus between the policy issue raised in the proposal and the company.

Overall, these interpretations of the ordinary business and economic relevance exclusions complicated shareholder efforts to advance proposals related to ESG issues, including climate change. The interpretations also effectively shut down shareholder proposals related to emissions targets, which were seen as too prescriptive (i.e., micromanagement).





The SEC will consider more proposals that relate to broad societal issues (including ESG) as significant to a company even if they're not necessarily related to the company's business.

Updated SEC policy reverses exclusions, hits definitions

On November 3, 2021, the SEC issued a legal bulletin (November Bulletin) that rescinded the Trump-era policies on the ordinary business and economic relevance exclusions summarized above.

Ordinary course exclusion and micromanagement

Regarding the ordinary business exclusion, the November Bulletin said the prior policy put “undue emphasis ... on evaluating the significance of a policy issue to a particular company at the expense of whether the proposal focuses on a significant social policy.” According to the SEC, this led to inconsistencies in the agency's exclusion determinations.

The November Bulletin thus provides that the SEC's policy on the ordinary business exclusion will focus on the social policy significance of the issues in the shareholder proposal. Staff have been instructed to consider whether the shareholder proposal raises issues associated with broad social impact. If yes, the SEC may no longer readily dismiss the shareholder proposal under the ordinary course exclusion.

Additionally, the November Bulletin reverses the prior interpretation of micromanagement under the ordinary business exclusion. Previously, the SEC broadly construed the micromanagement concept and considered basically any limit or prescription on company or board discretion as micromanagement. This allowed the prior SEC to more readily dismiss shareholder exclusions based on perceived micromanagement. The current SEC's interpretation of micromanagement focuses on the level of granularity sought in the proposal and the extent to which it inappropriately limits the discretion of the board or management. Essentially, this approach appears to signal that the SEC intends to narrow the application of the micromanagement concept.

Economic relevance exclusion

The economic relevance exclusion under section 240.14a-8(j)(5) allows a company to exclude a shareholder proposal that “relates to operations which account for less than 5 percent of the company's total assets at the end of its most recent fiscal year, and for less than 5 percent of its net earnings and gross sales for its most recent fiscal year, and is not otherwise significantly related to the company's business.” The SEC previously narrowly construed this language. However, the November Bulletin states that shareholder proposals that raise broad social or ethical issues now may not necessarily be excluded even if the relevant business falls below the 5-percent threshold in the exclusion.

Recent SEC action

SEC action under the new policy already appears to be impacting objections to shareholder proposals. An energy company recently objected to a shareholder proposal that the company report on how it is responding to the risk of stranded assets and natural gas infrastructure given climate change. The company generally argued that its existing reports and climate disclosures covered the shareholder's request. The SEC disagreed and rejected the company's objection, stating that the company's existing materials and disclosures did not substantially cover the shareholder proposal. As a result, the proposal will be considered at the company's upcoming annual meeting.

Overview

- The November Bulletin reverses prior SEC policy, which limited the ability of shareholders to advance proposals concerning ESG matters like climate change and emissions targets. The SEC will now consider proposals that relate to broad societal issues (including ESG) as significant to a company even if not necessarily related to the company's business.
- Policy changes reflected in the November Bulletin narrow the application of the micromanagement concept and suggest that the SEC may not exclude a shareholder proposal that includes emissions targets for greenhouse gases generated by the company's operations and products.





- The SEC’s policy changes ahead of the 2022 proxy season may result in the advancement of more proposals that could influence company policies on ESG issues. There are already reports for the 2022 proxy season of the SEC allowing climate-based resolutions to proceed to shareholder votes over company objections.
- The SEC’s policy changes may embolden “activist shareholders” to advance proposals with more detailed or aggressive ESG milestones.

About the authors

Ben H. Patton concentrates his practice on environmental and safety regulatory and compliance matters. He routinely counsels companies in connection with major industrial accidents, internal investigations and root cause analysis, workplace culture, compliance assurance, crisis response, whistleblowers, process safety incidents, and workplace injuries and fatalities. Ben also advises companies on government agency investigations and enforcement, environmental litigation, and responses to regulatory rulemakings.

Ben has a particular focus on the environmental and governance aspects of the firm’s ESG practice. He routinely counsels clients on risk management, environmental and safety social governance, and ethics in crisis response.

Jennifer A. Smokelin is a thought leader on environmental and emerging energy issues, greenhouse gas legislation, and related environmental issues, with particular experience in Pennsylvania, the mid-Atlantic, California, and the European Union.

Jennifer represents clients in a broad range of environmental and energy issues including environmental civil enforcement and litigation matters, as well as regulatory and transactional issues for energy and manufacturing companies. She has a particular focus on the environmental aspects of ESG, assisting clients with carbon footprint assessments, net zero plans, climate-related corporate reporting, ESG compliance, carbon offsetting and neutrality objectives, green energy, and renewables and alternative/sustainable fuels regulation.

A.J. Wissinger’s practice focuses on a broad range of environmental, health, and safety regulatory and transactional matters. He has extensive in-house experience at one of the world’s largest plastics, chemicals, and refining companies with several petrochemical plants and refineries located in Texas. While in-house, A.J. provided regulatory compliance advice under federal and Texas state environmental, health, and safety laws and defended enforcement actions brought by federal, state, and local authorities.



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Regulatory and enforcement trends at the CFTC and FERC: Spring 2022

Takeaways

- FERC now has a full quorum; imposes big enforcement fines
- Appeals court reverses FERC orders restricting gas pipelines
- FERC seeks tougher reliability standards for critical infrastructure
- CFTC pursues greater control over digital asset trading platforms
- Full quorum of CFTC commissioners expected soon

The Federal Energy Regulatory Commission (FERC) is increasing its scrutiny of climate-related oversight and ramping up its emphasis on reducing greenhouse gas emissions (GHG) investigations in light of an unprecedented number of appeals-court rulings highlighting this regulatory mandate. The Commodity Futures Trading Commission (CFTC) also continues to be tough on rule-breakers, enforcing its rules for derivatives markets and trying to expand rules it can use to regulate the use of digital assets.

FERC first quarter highlights

FERC now has a full commission: Rich Glick (chair), James Danly, Allison Clements, Mark Christie, and Willie Phillips. Phillips is the most recent addition and was unanimously confirmed by the U.S. Senate on November 16, 2021. He was sworn in as a commissioner on December 3, 2021, ending the two-two split. Chairman Glick's term will expire on June 30, 2022.

In 2021, FERC established the Office of Public Participation (OPP) to assist the public in participating in commission proceedings, and Elin Katz was appointed director. In February 2022, Nicole Sitaraman was named deputy director of OPP. According to FERC, OPP should be fully staffed by 2024.

Policy pronouncements tied up

On February 18, 2022, FERC issued two policy statements regarding its review and certification of interstate natural gas facilities: the Updated Policy Statement on Certification of New Interstate Natural Gas Facilities and the Interim Greenhouse Gas Emissions Policy Statement.

On March 3, the U.S. Senate Committee on Energy and Natural Resources held a hearing about the two policy statements. Senators Joe Manchin (D-W.Va.) and John Barrasso (R-Wyo.) expressed strong concerns that the policy statements could harm energy independence and security and impose additional costs on consumers. Additionally, dozens of parties (including 18 states) filed requests for rehearing and/or reconsideration of the policy statements. On March 24, at its monthly open meeting, FERC unanimously voted to designate the two as draft policy statements that will no longer apply to pending project applications. FERC also requested initial comments on the draft policy statements by April 25.





Appeals court decisions focus heavily on FERC's evaluation of pipeline applications

In *Food & Water Watch v. FERC*, the U.S. Court of Appeals for the District of Columbia Circuit held that FERC failed to adequately consider the effects that a new natural gas pipeline and compressor station would have on downstream GHG emissions. The circuit court remanded the case, ordering FERC to conduct a supplemental environmental assessment. Notably, the D.C. Circuit did not vacate the decision or revoke the certificate, because doing so would have been “quite disruptive” to the relevant pipeline construction, which was, at the time, “either mid-construction or already operational.”

In *Environmental Defense Fund v. FERC*, the D.C. Circuit vacated and remanded FERC orders approving the Spire STL pipeline, stating that FERC inappropriately based a finding of project need on a single precedent agreement with an affiliated shipper in a region with flat demand for natural gas. The circuit court also held that FERC failed to analyze whether the project would result in cost savings or other economic benefits.

Following the D.C. Circuit's decision to vacate FERC's orders, Spire STL filed an application for a temporary certificate. Spire STL stated that its affiliate would be unable to provide adequate retail service and ensure reliability to the St. Louis region, particularly during the winter months, if Spire STL was removed from service.

Acting *sua sponte*, FERC granted Spire STL a 90-day temporary certificate to ensure continuity of service but noted that the temporary certificate does not indicate how FERC will address Spire STL's request for a temporary certificate or the D.C. Circuit's remand. Spire STL's case is unprecedented insofar as the pipeline's certificate was vacated after the pipeline was already built.

FERC recently terminated a proceeding over whether Algonquin Gas Transmission should be permitted to put the Weymouth compressor station in service. FERC previously issued final orders granting a certificate to Algonquin to construct and operate the compressor station but, after problems with the compressor led to emergency shutdowns, FERC requested briefs to address whether the compressor should remain in service. Here, FERC was forced to assess whether the agency could revoke a certificate that was already granted. After briefs were submitted, FERC found that it has no authority to revisit the original certificate orders.

Continuing oversight results in significant fines for GreenHat and Rover

Since January 2021, FERC has demonstrated its commitment to oversee markets and impose significant penalties for infractions. In *GreenHat Energy LLC*, GreenHat was ordered to show cause as to why it and its owners should not pay \$229 million in fines and disgorge \$13.1 million in unjust profits for an alleged financial transmission rights market scheme.

In January 2022, FERC ordered an administrative law judge to address whether Rover Pipeline violated FERC's regulations that require Rover to provide full and forthright information in its pipeline certificate application under the Natural Gas Act. FERC's Office of Enforcement alleges Rover made misrepresentations and omitted material information concerning the status and intended treatment of a historic property in Dennison, Ohio.

Reliability standards for critical infrastructure being strengthened

In January 2022, FERC issued a notice of proposed rulemaking directing the North American Electricity Reliability Corp. to develop new or improved reliability standards that require internal network security monitoring for high and medium impact bulk electric system cyber systems. The notice is in response to the SolarWinds attack.





CFTC first quarter highlights

On March 28, the U.S. Senate unanimously confirmed President Joseph Biden's four CFTC commissioner nominees. The CFTC will soon have a full commission consisting of Rostin Behnam (chair), Kristin Johnson, Christy Goldsmith Romero, Summer Kristine Mersinger, and Caroline D. Pham.

Seeking public comment on disintermediation

In mid-March 2022, the CFTC requested public comment on an amended order of registration as a derivatives clearing organization by an entity (FTX US) seeking to offer non-intermediated clearing of margined products to retail participants. Chairman Behnam says the CFTC will be "careful, patient, and deliberative" in considering this groundbreaking proposal.

Regulation of digital assets

On February 9, Behnam stated in Congressional testimony that the CFTC would like to provide greater oversight of platforms where digital assets are traded and indicated support for a broadening of the scope of the CFTC's regulatory authority to encompass the digital assets spot market.

Addressing climate change

The CFTC has been focused on the role of derivatives in understanding, pricing, and mitigating climate-related risk, including through creating a climate risk unit and participating in the climate-related risk work of various international bodies. The CFTC has also shown support for having the derivatives markets play an important role in the orderly transition to a low-carbon economy through market- and product-based initiatives.

Global energy markets

The agency continues its work to monitor, identify, and address derivatives trading misconduct and market disruption around major events and catastrophes that create market volatility including disruptive events, such as Winter Storm Uri and COVID-19; and geopolitical events, such as Russia's war on Ukraine.

Enforcement priorities

The CFTC has been working with the U.S. Department of Justice in enforcing the Foreign Corrupt Practices Act, particularly when the underlying foreign corruption relates to physical commodity and derivatives trading in the United States. The CFTC has also prioritized the misappropriation of material non-public information, spoofing and manipulation, and supervisory violations.





About the authors

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Litigation risks



Litigation risk management in cross-border disputes and force majeure

Takeaways

- The pandemic has created difficult legal issues, particularly in foreign trade
- Application of civil law – prevalent in Latin America – may have serious implications in force majeure claims
- Proactivity is required to defend against force majeure claims

Cross-border disputes have been – and will continue to be – significantly impacted by the COVID-19 pandemic. Companies face a broad range of legal concerns arising from or relating to the outbreak, including labor, regulatory, supply chain, and liquidity issues. Moreover, government responses to the pandemic and the economic fallout of the COVID-19 crisis have affected parties' abilities to fulfill their contractual obligations. These challenges are becoming ever more complicated within the realm of cross-border business relationships given the variations in countries' responses to the virus.

Force majeure: What happens when contractual obligations are impossible to carry out

Legal issues are particularly complex where cross-border contracts are involved. This is in no small measure due to differences in how the virus is impacting and being managed in countries throughout Latin America and other regions around the globe.

For example, Peru's Public Procurement Supervisory Body in March 2020 decreed that the government's emergency declaration due to the pandemic constituted force majeure with respect to public contracts. For those jurisdictions that did not issue similar declarations, COVID-related questions and challenges will require determination on a case-by-case basis. Absent a specific and applicable declaration – such as Peru's – analyzing pandemic effects will require statutory and/or case-by-case contractual definitions of force majeure.

In Latin American, force majeure is frequently regulated by the applicable civil code found in a given jurisdiction and, as such, applicable contracts may not be required to specifically address all of the events that could come to constitute force majeure. Some jurisdictions, such as Argentina, Chile, Colombia, and Peru, explicitly define force majeure in their codes (see article 1730 of the Argentinian National and Civil Commercial Code, article 45 of the Chilean Civil Code, article 64 of the Colombian Civil Code, and article 1315 of the Peruvian Civil Code). Other jurisdictions, such as Mexico, do not. The basic elements of force majeure, however, are similar across jurisdictions – an unavoidable event outside of the parties' control that cannot be foreseen or overcome.





Some Latin American jurisdictions have express provisions that allow for termination and/or adaptation of a contract resulting from changed circumstances. For example, Brazil's Civil Code contains provisions that allow termination or adaptation of a contract due to "excessive" onerousness (see articles 478-480). The concept of "excessive onerousness" is broader and more permissive than "impracticability" under, say, the U.S. Uniform Commercial Code. Lawyers are now attempting to incorporate these types of provisions – regardless of their own respective legal system – into their contracts to expressly allow for the modification of contractual terms based on changed circumstances.

International contracts in Latin America will call for the application of both civil and common law particularly as they relate to project financing agreements. Critically, the doctrines of force majeure and impracticability in common law jurisdictions, such as the United States, are often stricter than similar doctrines in Latin America. For example, in the United States, changes in market conditions or increased costs to perform may not represent impracticability, thereby excusing non-performance. Conversely, some Latin American jurisdictions may excuse non-performance where conditions are deemed sufficiently severe. In the United States, force majeure has largely become a contractual matter, with courts often preferring to avoid excusing performance where force majeure events have not been expressly mentioned within an applicable contract.

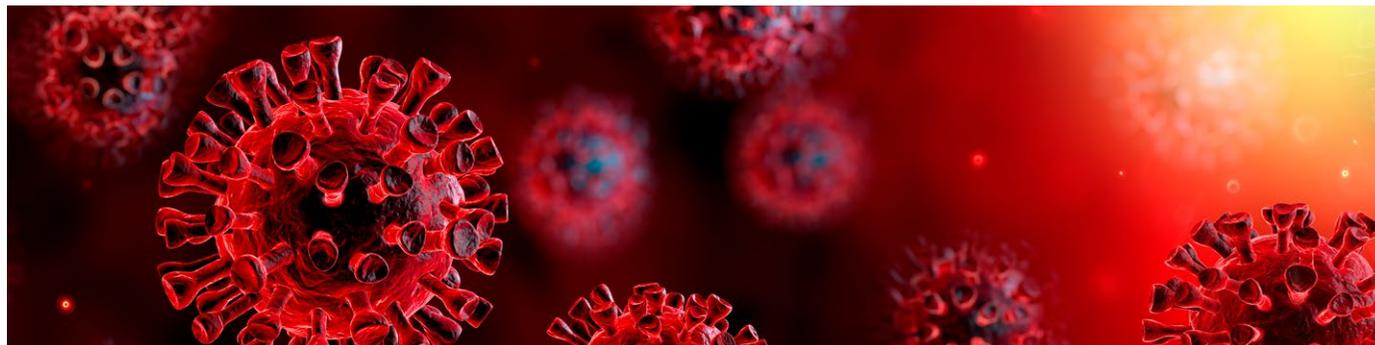
Responses to litigation risk management challenges caused by COVID-19

In order to minimize risks arising from force majeure events, it is crucial to be proactive and identify potentially affected contracts early. A premium should also be placed on developing a coherent strategy to be applied in a uniform manner. Inconsistent approaches may present challenges in litigation.

Once a potential force majeure event has occurred, where possible, efforts should be made to document what transpired. The party claiming an impact will often bear the burden of proof – be it force majeure, impracticability, or excessive onerousness. Depending on the jurisdiction and applicable law, the party might need to produce verifiable documentation of delays, disruptions, and supply chain issues.

The party responding to a claim, on the other hand, may look to obtain documentation and test the counterparty's assumptions. Knowing what the contract requires, whether the impact was foreseeable, and what mitigating actions the counterparty took to minimize impact, could be important.

Be careful when drafting force majeure clauses. Any attempt to list every contingency that might be considered a force majeure event is itself an impossibility. However, a carefully drafted clause that includes applicable catch-all provisions may prove useful in capturing events beyond those specifically listed. In addition, while defenses such as impossibility, impracticability, and frustration of purpose generally require that an event excusing performance be unforeseeable, parties are generally free to fashion force majeure clauses as they see fit – including to attempt to excuse foreseeable risks.





About the authors

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