LAW360

Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

State Of Energy Dealmaking: Midyear Report

By **Keith Goldberg**

Law360 (July 1, 2022, 4:27 PM EDT) -- A transactional resurgence for the gas industry and surging prospects for solar development have made 2022 a busy year for energy deal work, but attorneys are grappling with an added degree of difficulty that could continue through the rest of the year.

Geopolitical and economic turmoil has raised energy and commodity prices, making it trickier to strike deals and increasing project development costs.

The gas industry continues to enjoy a transactional renaissance, while solar development is poised to rebound in the second half of the year after President Joe Biden gave the industry a two-year reprieve from a tariff circumvention probe that stalled a lot of first-half work.

Here, attorneys share with Law360 four things that sum up the state of energy deal making at the halfway point of this year:

A Choppy First Half for Energy M&A

There hasn't been a lack of multibillion-dollar energy deals — a $6 billion March merger between independent drillers Whiting Petroleum Corp. and Oasis Petroleum Inc. and a $7 billion May combination between drillers Colgate Energy Partners III LLC and Centennial Resource Development Inc. are just a couple that have been struck so far this year. But compared to a frothy 2021, energy merger and acquisition activity in 2022 has been in fits and starts, attorneys say.

Oil and gas prices have skyrocketed amid the Russian invasion of Ukraine, with U.S. inflation hitting levels not seen since the 1970s, but questions over how long those conditions will last make deal negotiations a challenge, attorneys say.

"With commodity prices as high as they are, there's a ton of people out there who would like to sell, but not too many that are willing to buy at these valuations," said Skadden Arps Slate Meagher & Flom LLP partner Eric Otness, who heads the M&A and corporate group in the firm's Houston office. "How long are the prices going to stay at this level? How long does it need to continue before you see people comfortable doing bigger deals in the space?"

Attorneys say clean energy deal making has been similarly uneven. While there have been big-ticket deals, such as a Shell PLC unit paying $1.55 billion for Indian renewable energy developer Sprng Energy in April and Chevron Corp. paying $3.15 billion in February for biofuels producer Renewable Energy

Group Inc., buyers are pumping the brakes on some of the high valuations placed on renewable assets as inflation has taken some of the shine off some big deals brokered last year, and rising interest rates raise development costs.

"There's a lot of money chasing an ever-decreasing number of deals," said Ed Zaelke, who co-heads McDermott Will & Emery LLP's energy and project finance practice. "That's true both in terms of sales of development companies as well as sales of portfolios of fully developed and operating assets."

Amid all the economic and geopolitical uncertainty, attorneys say money continues to flow toward companies and project platforms that tackle the long-term transition to zero-carbon and low-carbon energy, from transportation electrification to hydrogen and carbon capture.

"Those deals are going to continue to get done, particularly when we're talking about long-term commitments and not just a short-term exchange of assets," said Kfir Abutbul, who co-chairs Paul Hastings LLP's global energy transition and infrastructure team.

Persistently Pricier Projects

Energy development costs were already rising thanks to global supply chain disruptions exacerbated by the COVID-19 pandemic. But attorneys say rising inflation in 2022 has only compounded the supply crunch, while rising interest rates generally drive up capital costs and make it difficult to secure any short-term or medium-term financing, such as project construction loans.

"Inflation, interest rates, and supply chains," said Milbank LLP partner Allan Marks, who works extensively on renewable energy development. "Those are the things keeping me up at night."

In the power and renewables sector, rising costs have undermined the financial viability of many power purchase agreements and in some instances, developers are walking away from projects, attorneys say.

"Costs are under so much more scrutiny given how fast they are rising," said Skadden energy and infrastructure projects partner Aryan Moniri. "Not just the cost to build, but financing costs, unknown costs in form of tariffs, tax uncertainty."

Attorneys say the oil and gas sector isn't immune to the inflation of project development costs, even as high prices create more incentive to drill. Jason Bennett, who chairs Baker Botts LLP's global projects practice, said a major drilling project can take between 12 and 18 months, but if oil prices drop significantly during that time, a project that looks great now becomes a financial disaster.

Inflation is "a disruptive factor that will limit development of large-scale projects because pricing is so unknown," Bennett said.

A Gusher of Gas Deals

Deal making in the gas sector began to increase last year as gas prices shot up after years at rock-bottom levels. Attorneys say the pace has picked up this year as gas prices are at their highest levels in over a decade, fueled in part by increased demand for liquefied natural gas amid the Russian invasion of Ukraine.

On the upstream side, Chesapeake Energy Corp. in January agreed to pay $2.6 billion in cash and stock for Marcellus Shale driller Chief E&D Holdings LP. In the midstream sector, deals included Targa Resources Corp. in June paying $3.55 billion for Delaware Basin-based pipeline and processing firm Lucid Energy Delaware LLC, and pipeline giant Williams in March shelling out $950 million for Trace Midstream's gas gathering infrastructure in the Haynesville Shale of east Texas.

Austin Elam, who co-chairs Haynes and Boone LLP's oil and gas practice group, said capital that for years had flowed out of gas-heavy regions like the Marcellus and Haynesville toward oil-heavy regions is now flowing back.

"It's interesting, and welcome, to see that there's renewed optimism, activity and development in the gas-focused spaces," Elam said.

Bennett of Baker Botts said the pace of gas development will be a key thing to watch in the second half of the year, especially any advancement on proposed LNG projects if the war in Ukraine drags on. In June, Cheniere Energy Inc. said it's moving ahead with investment in and construction of the third stage of its Corpus Christi liquefaction project in Texas.

"How many LNG projects will make a final investment decision by the end of the year?" Bennett said. "It's important to see how fast the industry can move to meet demand."

Tariff Probe Stalls Solar Work, But Brighter Times Ahead

The solar industry was rocked in March when the U.S. Department of Commerce launched an investigation into allegations by U.S. solar panel manufacturer Auxin Solar Inc. that Chinese manufacturers are evading tariffs by shifting production to other countries, raising the potential for additional, retroactively applied duties.

Solar industry groups argue the probe will further squeeze already tight global supply chains and ultimately chill U.S. solar development, and several companies announced solar project delays in the wake of the investigation.

But Biden eased industry concerns in June when he issued an order creating a 24-month exemption for solar equipment purchases from the four Southeast Asian countries named in the Commerce probe. Attorneys say solar developers will be in full catch-up mode in the second half of 2022.

"For renewables, the big challenge was on the solar tariff circumvention case," Marks of Milbank said. "Once the Biden administration said that it's going to suspend those tariffs, that gives projects better price certainty, and we'll see a lot of pent-up activity in the second half."

But the relaxation of the Auxin case won't completely cure the supply chain issues facing solar developers, attorneys say.

"The Auxin petition was covering up the fact that many developers are struggling with supply chain issues," said Neeraj Arora, who co-leads Morgan Lewis & Bockius LLP's global energy industry team. "The impact of Auxin will likely be blunted by this executive order, but is that really going to do the trick? We shouldn't presume that it will resolve all the headwinds."

For example, the Uyghur Forced Labor Prevention Act went into effect June 21. The law largely bars any products from China's Xinjiang region from being imported into the U.S., which could sharply limit access to a key global hub for the raw materials of solar projects.

--Additional reporting by Benjamin Horney, McCord Pagan and Morgan Conley. Editing by Marygrace Anderson and Alyssa Miller.