

Bet-the-Company Regulation

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Advising the Board

Like bet-the-company litigation, bet-the-company regulation can have wide-ranging financial and operational consequences for a company. Often technical and unpredictable—and hard to quantify for financial reporting purposes—regulatory risks and contingencies may not receive the same level of oversight by the Board of Directors, and may catch the company by surprise.

A Board may not track all the technical details of shifting regulatory standards, but regular Board briefings can provide an early warning system for company-changing regulation and risks.

Pricing

The company or its suppliers or customers may be vulnerable to regulatory approval of prices and tariffs. A regulatory review of pricing might change pricing fundamentals for the company, and might change the cost structure of customers or suppliers.

- *For example—open seasons:* “Open seasons” are held under rules of the Federal Energy Regulatory Commission (FERC) whenever a pipeline is built and later from time to time to allow gas producers and shippers to identify each other, indicate interest in the pipeline and reach agreement with regulators on costs, tariffs and other terms. An open season can increase or lower revenues received by a pipeline company and change transportation costs paid by customers. Board briefings may cover the timing of the open season, expected changes in tariffs and other conditions, and geographic impact. Sensitivity analysis may assist the Board to understand the range of potential changes in the company’s financial results at different pricing levels.

Disclosures and Competitive or Reputational Risk

Regulators may ask the company for competitively sensitive information about the company's industry, business or proprietary processes. Board members should be informed if such information may be provided to the government, and the risks that public disclosure may follow.

- *For example—hydraulic fracturing:* Federal and state regulators continue to review methods and fluids used in hydraulic fracturing associated with unconventional drilling and shale gas.
- *For example—reserve estimates:* In 2011, the Securities and Exchange Commission (SEC) and the New York attorney general issued subpoenas seeking information regarding the estimated commercial life of shale gas wells, the prospects for natural gas wells and reserve estimates.

Environmental and Climate Regulation

Environmental and climate regulation can affect the feasibility and profitability of a company's business strategy, such as M&A, organic growth, geographic footprint, products and financial returns.

Government requirements may even change the business model followed by a company or division.

- *For example—changes to facilities:* The New York attorney general, together with other agencies, negotiated settlements that required coal-burning power plants to reduce emissions and undertake other modifications to facilities. The settlements required some plants to be shut down or converted to natural gas. Some companies also agreed to provide detailed public disclosures about climate risk.

M&A: Deals, Documents and Delays

Many M&A deals depend directly or indirectly on regulatory approvals, and may be subject to regulatory risks during the period between signing and closing. Regulatory approvals may be a condition to closing, and one or both parties may have a right to terminate if adverse regulatory developments affect the economics of the transaction.

Large transactions may require a filing under the Hart-Scott-Rodino Antitrust Improvements Act (HSR Act). The HSR Act generally applies to acquisitions of voting securities, assets and other interests that meet the “size-of-person” and/or “size-of-transaction” tests.

- *For example—waiting period:* The HSR Act imposes a waiting period before closing a transaction and may result in further delays. The HSR Act also presents risks of a “second request” and divestitures of assets or lines of business.
- *For example—Board documents:* Unless advised in advance, the Board may be surprised to find that Board presentations, documents and even handwritten notes may be gathered and submitted to the government as part of an HSR filing. The government reviews these Board documents, referred to as “4(c)” documents, in connection with assessing potential antitrust implications of the transaction.

Confidentiality and Privilege

Dealing with regulators, investigations or government filings can result in competitive harm, waiver of confidentiality and legal privilege, third-party lawsuits and loss of business confidentiality. Government positions regarding confidentiality and legal privilege shift over time. The Board should monitor the company’s procedures to protect confidentiality and privilege, any waiver of privilege and the potential for public disclosure of business data if requests are

submitted under the Freedom of Information Act (FOIA) and similar statutes.

- *For example—tariff and terms:* A tariff filing with the FERC must include material terms of the transportation arrangements, some of which may signal business strategies to competitors. Other contracts may not be public until filed or submitted to regulators.

Appeals and Contests

The Board should be advised if regulatory rulings are subject to appeal or contests from customers, and should also be aware of the timeline and potential outcomes of contests and related litigation.

- *For example—FERC proceedings:* Rate cases and customer protests may lead to a refund for customers if determined against the pipeline. A Board should be made aware of the range of potential refunds and related costs.

Compliance Costs

Regulation may impose compliance costs by mandating capital expenditures and requiring a company to gather data on its operations. In connection with a company's budget process, the Board may benefit from a briefing on regulatory compliance costs and any expected increases.

- *For example—drilling moratorium:* An explosion in April 2010 on a drilling rig in the Gulf of Mexico resulted in a federal moratorium on deepwater drilling. The Department of the Interior called for higher safety standards. Even after the moratorium was lifted, government regulators issued few permits for drilling in the Gulf, and announced they would develop additional rules and guidelines. See article on law360.com (www.law360.com/articles/192366/salazar-and-far-reaching-changes-at-boemre).

- *For example—climate change disclosure:* In 2010, the SEC issued an interpretation that public companies are required to disclose climate change-related risks, including anticipated legislation and regulation, indirect business consequences and physical impacts.

Regulation and Risk Oversight

Regulation receives less scrutiny than litigation, but regulatory shifts and adverse rulings may have a similar fundamental impact on the company and its business model. Even a “non-regulated” company may have key business relationships with regulated entities. To assist the Board in its oversight of regulatory risks, regular Board briefings may include:

- Price and revenue impact of prospective regulatory changes, and sensitivity analysis,
 - Timing and potential delays in closing transactions and pursuing organic growth strategies,
 - Possible challenges, disputes and refunds associated with regulatory action,
 - Potential competitive harm from disclosure of business information filed with or submitted to regulators, potential waiver of privilege and litigation risks, and
 - Costs of compliance, including the cost of gathering information required by regulators.
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A Modern Energy Practice

The energy industry long ago secured its rightful position at the epicenter of the global economy. Every day the businesses that develop, produce, transport and market oil, natural gas and electric power face decisions with global scope and bet-the-company consequences. However, this once-traditional industry has also proven it is not a one-trick pony. The modern energy market is a leader in business, capital and innovation. With traditional energy, oil and gas at its core, Andrews Kurth has parlayed their extensive industry experience into a full spectrum of energy services. Whether our clients need help with regulatory approval, a complex project financing, a facilities construction contract, an acquisition or a lawsuit, Andrews Kurth has the industry knowledge and legal skill to get the job done. Our lawyers have earned a preeminent reputation in this big stakes, high-impact industry. We have a track record for success that few law firms can match and the energy to propel your business forward.

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Now that is straight talk about energy. For more information about Andrews Kurth's Energy Practice, or to learn more about our energy attorneys, please visit our website at www.andrewskurth.com/practices-Energy_Practice.html.



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Shemin is the Managing Partner of the Washington, DC office. She represents major energy companies, including natural gas pipelines, energy marketing and trading companies, and midstream service providers, in proceedings before the Federal Energy Regulatory Commission and has represented natural gas pipelines before the federal courts. Shemin also works with clients seeking to construct natural gas storage and liquefied natural gas facilities. In addition, she has counseled energy companies on natural gas matters arising from bankruptcy and has experience in the antitrust area. She received her J.D. in 1990 from Harvard Law School and her A.B. from Harvard-Radcliffe College in 1987.



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