

# Energy Transition

## INSIGHTS

August 26, 2024

## Energy Transition Mid-Year Review

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Since the beginning of 2024, we have seen continued activity and interest in energy transition projects and regulations in the United States, the European Union and across the world. Drawing on our experience advising a range of clients—including alternative and traditional energy companies, developers, private equity firms, family offices and financial institutions—we have outlined major developments since the beginning of the year. We encourage you to reach out to us with any questions.

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### UNITED STATES

#### Battery Component Requirements and FEOC Restriction to Electric Vehicle (EV) Tax Credits

The U.S. Inflation Reduction Act of 2022 (the “IRA”) amended and extended 26 U.S. Code § 30D to provide for a maximum tax credit of \$7,500 per qualifying new clean vehicle, consisting of a \$3,750 credit for vehicles meeting critical minerals requirements and another \$3,750 for vehicles meeting battery component requirements. On May 6, 2024, the U.S. Department of Treasury (the “Treasury”) and the Internal Revenue Service (the “IRS”) published the final regulations that determine qualification for the 30D Credit which became effective on July 5, 2024. To meet the battery component requirement, the applicable percentage (60% for 2024 and 2025; 70% for 2026; 80% for 2027; 90% for 2028; and 100% thereafter) of the value of the battery components of a clean vehicle must be manufactured or assembled in North America. To satisfy the critical minerals requirement, the applicable percentage (50% for 2024; 60% for 2025; 70% for 2026; and 80% thereafter) of the value of the critical minerals contained in an EV battery must be (i) extracted or processed in the United States or a country with which the United States has a free trade agreement or (ii) recycled in North America. The 30D Credit is not available if (i) the battery contains critical minerals extracted, processed, or recycled by a foreign entity of concern (“FEOC”) (for vehicles placed in service after December 31, 2024) or (ii) the vehicle’s battery contains battery components manufactured or assembled by a FEOC (for vehicles placed in service after December 31, 2023).

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## S&C Resources

- [Final Rules on Clean Vehicle Tax Credits](#)
- [Proposed Guidance on the US Clean Vehicle Credit—Critical Minerals and Battery Components Requirements](#)
- [DOE's Proposed Guidance on 'Foreign Entity of Concern'](#)

## Opportunities in Critical Mineral Deal-Making

Given their importance to the energy transition, critical minerals have emerged as a key focus of financing and M&A transactions over the past year. In particular, copper—an essential component of renewable energy infrastructure and electric vehicles—is expected to face burgeoning demand, and companies worldwide have shifted their business development strategies to increase exposure to this metal. S&C has been at the forefront of many of these transactions, advising Minera Centinela on a project financing for the doubling of Minera Centinela's annual copper production, Teck on the spin-off of its steelmaking coal business to refocus on its copper portfolio and Lundin Mining on its joint acquisition with BHP of the Filo del Sol copper project in Argentina, one of the largest undeveloped copper deposits in the world. We expect this trend to continue, in respect of both copper and other critical minerals, as countries seek to secure and diversify the supply chains for these important resources.

Notably, in order to reduce dependency on supplies from China, companies in recent months have made significant investments in the United States, the EU, Australia, Canada and elsewhere for the production of rare earth metals. In terms of legislative efforts, on May 23, 2024, the Critical Raw Materials Act (the "CRMA") entered into force in the EU after the new regulation was signed on April 11, 2024. The first proposal for the CRMA was published on March 16, 2023 (the "CRMA Proposal") and together with the Net-Zero Industry Act, the purpose behind the CRMA is to develop "secure and sustainable access" to critical raw materials for the EU. The CRMA identifies and seeks to protect European supply chains of critical and strategic raw materials, including by regulating the procedure, funding, disclosure and financing of "Strategic Projects", which are projects involving the extraction, processing, refining and recycling of strategic raw materials that are entitled to considerable procedural privileges (including benefiting from a fast track permit process). The CRMA differs from the CRMA Proposal in the following key respects: (i) the list of strategic raw materials contained in the CRMA will be reviewed by the European Commission more frequently; (ii) the maximum time limits for the fast track permit process have been lengthened; and (iii) the scope of the obligation on large companies to conduct risk assessments in respect of their strategic raw materials supply chains in relation to certain strategic technologies has been narrowed.

## S&C Resources

- [EU Critical Raw Materials Act Enters Into Force](#)

## Hydrogen-based Legislative Frameworks Continue to Emerge Around the World

As we discussed in our 2023 year-end review, there remains a robust interest in clean hydrogen, not only in the United States but also around the world. Although there have been no significant U.S. updates since the [proposed regulations](#) issued in December 2023 regarding the clean hydrogen tax credit, other countries have since proposed their own set of incentives for hydrogen production. For example, Japan's Hydrogen Society Promotion Act subsidizes suppliers of low-carbon hydrogen. This subsidy scheme lasts for a 15-year period, beginning in 2024, and is available for domestically- and foreign-produced low-carbon hydrogen. Although principally applicable to domestic producers, for overseas producers and shippers, the Japanese government will subsidize both production and shipping costs. The amount of the subsidy provided to suppliers of low-carbon hydrogen will be the difference between a fixed or variable "base price" and variable "reference price". This development in Japan, together with the criteria for green hydrogen in Europe, are key factors for developers considering the optimal market for hydrogen and ammonia offtake. Finalization of the proposed regulations related to the tax credit for production of clean hydrogen in the United States will similarly inform prospects for hydrogen and ammonia demand markets. Clarity in relation to these legislative frameworks will help developers and investors to better understand the structures, geographies and offtake terms that support final investment decisions and financing of hydrogen and ammonia projects.

## A New Legislative Framework, European Developments and an Increased Focus on Partnership

In April, the U.S. Environmental Protection Agency (EPA) released final regulations, which became effective July 8, aimed at reducing pollution from fossil fuel-fired power plants. The final EPA regulations aim to curb greenhouse gas emissions by establishing (i) emission guidelines for existing fossil fuel-fired steam-generating units and (ii) new performance standards for new and reconstructed fossil fuel-fired stationary combustion turbines and coal-fired steam-generating units that undertake large modifications. Existing coal-fired steam-generating units operating on or after January 1, 2039 are required to reduce their annual emissions by 88.4% (based on implementation of carbon capture/sequestration and storage (CCS) with 90% capture) by January 1, 2032. Coal-fired steam-generating units that undertake modifications increasing their hourly emission rates by more than 10%, as well as newly-constructed stationary combustion turbines, are now also subject to performance standards mirroring these emission guidelines.

At the same time, pursuant to the [EU's target to reduce net emissions by 90% by 2040](#), and the [EU Industrial Carbon Management Strategy](#) adopted in February 2024 (see [S&C Client Memo for more details](#)), the EU Commission has recently proposed a number of regulations and policies to facilitate the development of technologies and infrastructure to capture, store, transport, use and remove CO<sub>2</sub>, along with a uniform regulatory and investment framework. Two key initiatives are summarized below:

- **EU Certification Framework for Carbon Removals Regulation (the "CRFC Regulation"):** The [CRFC Regulation](#) is expected to create the first EU-wide voluntary framework for certifying high-quality and permanent carbon removals, carbon farming and carbon storage in products based on certain quality criteria. To facilitate adoption, the CRFC Regulation aims to create

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widely accepted standards for monitoring, reporting and verifying carbon removals in the EU. The CRFC Regulation also addresses costs and greenwashing concerns of stakeholders, through standardized baselines and group auditing. Moving forward, the CRFC Regulation will likely enter into force by the beginning of 2025 (see [S&C Client Memo for further details](#)); and

- **Trans-European Transport Network Regulation (the “TEN-T Regulation”):** The [TEN-T Regulation](#) is set to incentivize the construction of CO2 transportation infrastructure in Europe. In short, the TEN-T aims to create effective and sustainable transportation of CO2 by creating an EU-wide and multimodal transport network, including, but not limited to, railways, inland waterways, shipping routes and roads linked to cities, maritime and inland ports. Crucially, this regulation sends a clear message to market participants: the EU is committed to building the necessary CO2 transportation infrastructure, and recognizes the role of different transport modalities in the carbon capture sector. Promisingly, the TEN-T Regulation entered into force in July 2024, and its [Core Network](#) (i.e., most significant connections linking cities and nodes) is predicted to be completed by 2030.

### S&C Resources

- [Recent Developments in the Carbon Capture Sector in the U.S. and Europe](#)
- [California Resources Corporation to Combine with Aera Energy](#)

### Monetization of Energy Tax Credits

The IRA not only introduced a range of new and enhanced clean energy-related tax credits, but also created two new ways for taxpayers to monetize these credits. First, under 26 U.S. Code § 6417, tax-exempt and government entities (and for certain credits, taxable entities as well) can elect to receive tax credits as a fully refundable direct payment. Second, under 26 U.S. Code § 6418, non-tax-exempt taxpayers can elect to transfer all or a portion of their tax credits to unrelated parties for cash.

On March 5, 2024, the Treasury and the IRS released final regulations on direct payment of tax credits, which became effective on May 10, 2024. The final regulations largely reflected the proposed regulations issued in June 2023, with some notable exceptions and clarifications. For example, while the final regulations confirmed that “chaining” transactions (i.e., a tax-exempt or governmental entity first purchasing credits through transferability and then electing to receive a direct payment for those credits) is not permissible, the Treasury and the IRS released Notice 2024-27 requesting comments on situations in which a chaining transaction could be allowed. Moreover, the final regulations confirmed that partnerships and S corporations are generally excluded from making a direct pay election, even if all the partners or shareholders are taxpayers eligible for direct pay election. However, the Treasury and the IRS simultaneously issued proposed regulations under 26 U.S. Code § 761 to provide guidance for certain unincorporated organizations to elect out of the partnership rules under Subchapter K. Finally, the final regulations contained clarifications regarding the procedure for making a direct pay election and the determination of the amount of direct payment.

Additionally, on April 25, 2024, the Treasury and the IRS released final regulations regarding the transfer of tax credits, which became effective on July 1, 2024. Similar to the final regulations for direct pay, the

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final regulations for transferability largely reflected the proposed regulations issued in June 2023, with some notable exceptions and clarifications. For example, the final regulations clarified that partnerships that have not made the direct pay election can qualify for the election to transfer the tax credits, including partnerships with tax-exempt or government entity partners. Furthermore, the final regulations confirmed that only “vertical” credit transfers are permitted, meaning that base credits cannot be severed and sold separately from any bonus credits. Finally, there were other clarifications and changes regarding the procedure for making the transfer election, such as allowing the election to be made or revised on a superseding return and allowing numerical errors to be corrected on an amended return or by filing an administrative adjustment request.

### S&C Resources

- [S&C Energy Transition Insights: Final Regulations on Transferring Tax Credits](#)
- [New Guidance on Direct Pay and Transferability of U.S. Clean Energy Tax Credits](#)
- [Energy Transition Insights: Buying U.S. Clean Energy Tax Credits? Key Considerations](#)

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Questions regarding the matters discussed in this publication may be directed to any of the lawyers listed on S&C's [Energy Transition Practice](#) page or any Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters.

Additional S&C resources about energy transition matters may be found [here](#).

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