The same thing, only different

Why renewable energy needs alternative approaches to ADR

Gordon Nardell QC MCIArb

gordon.nardell@39essex.com

ThirtyNine
ESSEX STREET

Scope of this presentation

- "In law, context is everything": Lord Steyn, *Daly v. Home Secretary* (2001)

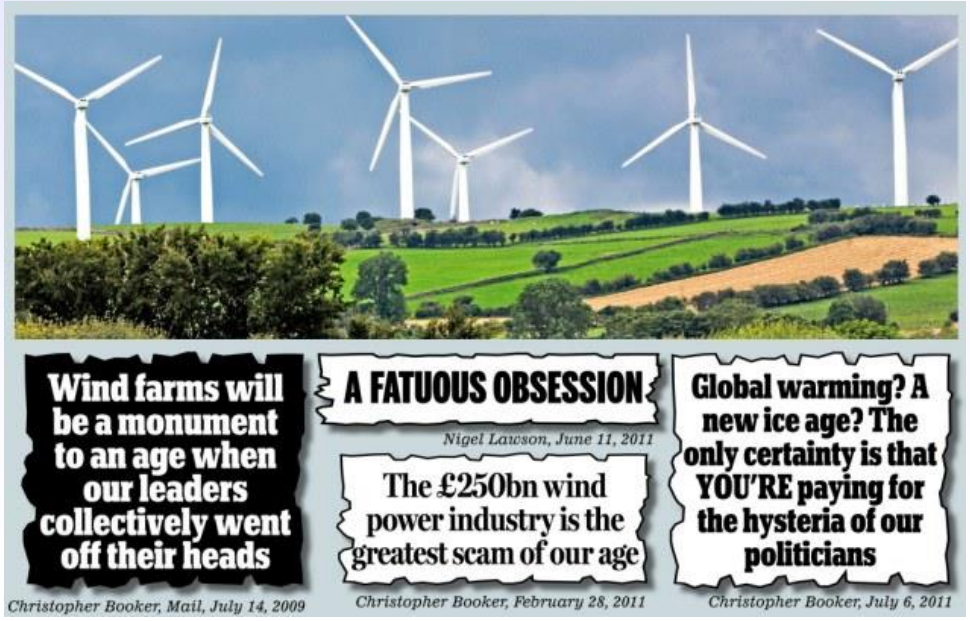
- Nothing special about renewable energy…
  - A tonne of concrete is a tonne of concrete
  - "Renewable" and "fossil" electricity taken off grid and sold to consumers are identical

- But important features of renewable energy that create particular kinds of dispute… and particular problems/pitfalls in resolving them

- Overview of some distinguishing features of the renewables context – esp. public policy and geography. Plus a case study (and a short point about pathological clauses if time)

The public policy context (1)

- Renewables sector highly sensitive to public policy:
- Overall investment climate depends on degree of political commitment, which is variable and driven by a variety of factors:
  - Climate change mitigation, decarbonisation of energy supply
  - Reliance on fossil fuels from sources affected by geopolitical risk
  - Domestic politics
- Packages of supply-side, demand- side and regulatory measures, all shaping the framework for contractual relations



The public policy context (2)

- Economic instruments: subsidies (supply side) and levies (supply and demand sides)
- Supply side and benefits:
  - Reflect high capex relative to running costs
  - Legislative mechanisms, eg FiTs, CfDs
  - Degree of certainty of revenue stream over life of project? What happens where changes occur mid-stream?

- Demand side and burdens:
  - Subsidies etc. financed by imposing charges on non-renewable generation/supply
  - Charges also fund demand-reduction measures – eg in UK, ECO (Energy Companies Obligation) – formerly CESP (Community Energy Saving Programme) and CERT (Carbon Emissions Reduction Target)
  - Huge potential for disputes

The public policy context (3)

- Regulation generally: projects and downstream trading
- Environmental impacts of renewable energy projects:
  - a huge issue in EU and, increasingly, elsewhere
  - Significant risk of third party challenge and/or intervention by regulator, eg. biodiversity impacts of coastal offshore wind projects
- Wholesale and retail gas/electricity markets: elaborate systems of regulation of retail pricing, wholesale trading arrangements, cross-ownership, transmission/distribution

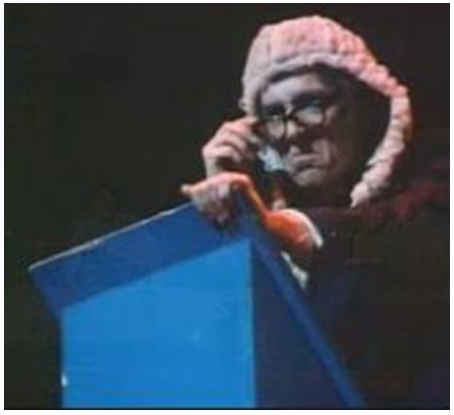
So…

- Disputes tend to occupy chaotic boundaries between law/politics, public/private law, national/international law

- Familiar contractual concepts can give rise to unfamiliar problems: eg. operation of penalty/indemnity clauses where “loss” is regulatory action (the case study)

- Public policy risk/uncertainty produces high project failure rate:
  - Disputes are frequently about things that don’t get built
  - But characteristics of industry mean operators must make significant financial commitments early on
  - How far down the contractual chain can risk be passed?

- Complexity of funding/contractual arrangements:
  - Multiple parties have an interest in project disputes
  - Choice of DR mechanism needs to be suited to addressing multiple interests



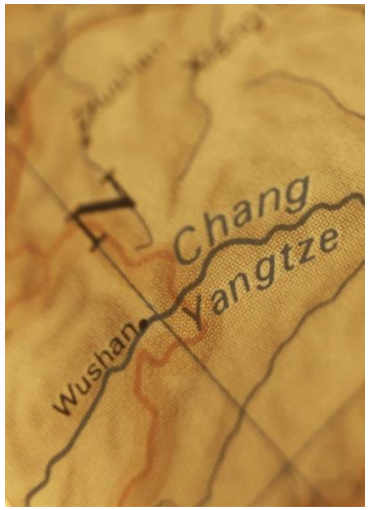
Where's it all happening?

- Global shift is inexorably eastward

- China 2012 -- in national terms, largest single generator of energy from wind:
  - 75GW installed capacity, 100.2 TWh total output
  - Whole EU was 106GW, 180TWh
  - China likely to dwarf EU in terms of future trends: wind currently only 2% of national generation (cf. coal 75%), but major policy commitment to achieve 200GW installed capacity by 2002 = a 266% increase in 8 years.
  - In EU highest national % increase for total renewables 2010-2020 under Renewable Energy Directive is 49% (lowest is 10%)!

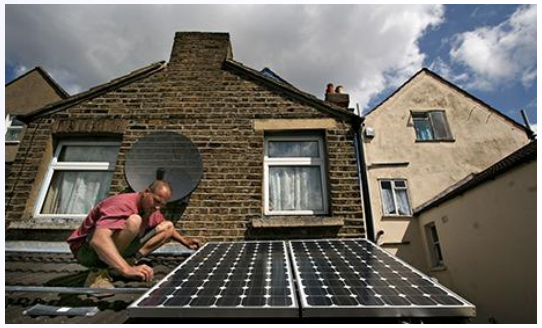
- Choice of dispute resolution mechanisms will have to increasingly accommodate Asian business culture(s)

- Exotic/complex funding arrangements and State involvement generate specialised kinds of dispute



A case study: regulation meets contract

- UK CESP/CERT schemes:
  - “in kind” obligations on suppliers /generators to undertake energy efficiency improvements to housing stock.
  - “Points” system, with regulatory penalties (Ofgem) for non-compliance – capped at 10% of turnover but potentially huge eg. £400M for Scottish Power (turnover £4Bn). Much less for smaller companies, eg say £20M.
- Companies outsourced improvement work under a variety of forms of contract, some containing standard commercial wording excluding “penalties” from recoverable loss unless due to “deliberate” breach.
- Compliance cost rocketed
- Issues where sub-contractor in breach:
  - Are regulatory penalties excluded by “no penalties” clause even though that’s the only possible loss?
  - Is it reasonable mitigation for the company to spend an extra (say) £10M to achieve limited additional compliance if its penalty can’t exceed £20M and will probably be much less?
  - Really suited to ADR techniques such as voluntary adjudication?



ADR good, pathological clauses bad

- The inverse problem to the case study – parties negotiating non-standard contracts to accommodate complexity and cultural expectations in international energy project/investment agreements

- Risk that multi-tiered ADR provision will enable a party to delay arbitration indefinitely or challenge jurisdiction

- Crucial to ensure absolute clarity as to:
  - What a party has to do to comply with its ADR obligations
  - The point at which ADR is treated as having failed, enabling a valid reference to arbitration to be made.