GLOBAL ARBITRATION IN THE ENERGY SECTOR

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GLOBAL ARBITRATION IN THE ENERGY SECTOR
MINI-ROUNDTABLE

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Kent Phillips, a partner in Hogan Lovells Singapore office, has over 20 years’ experience as a dispute resolution lawyer with a concentration on international arbitration. He conducts all stages of proceedings from interim measures to advocacy at trial. Mr Phillips has conducted arbitrations under all the leading institutional rules and regularly sits as an arbitrator.
CD: Could you outline some of the key trends in energy sector arbitration over the past 12 to 18 months? Are there any particular industries with more or fewer disputes?

Gonzalez: One of the key trends in the energy sector over the past 12 to 18 months has been disruption – specifically, disruptions affecting the construction of energy projects. One of the interesting trends stemming from the pandemic is that the interpretation and application of the force majeure contractual provisions in construction contracts has had to evolve. Although the coronavirus (COVID-19) pandemic is certainly no longer an unknown and unexpected event, the effects of force majeure, from labour to supply chain issues, are still impacting projects in new and different ways, hence leading to more disputes. The handling of disputes has also been disrupted. At the beginning of the pandemic, 100 percent of disputes were being handled virtually, and now there are more hybrid hearings. However, even with hybrid hearings, there are still issues given that some parties, witnesses or arbitrators are available in person while others are not. And this is creating a debate about whether there is a fair and balanced hearing process.

Phillips: Today, there is more gamesmanship, strategy and tactics that are needed in hybrid hearings, from arbitrator selection to routine arbitral processes. It is a really interesting time to be handling disputes within the energy sector.

Carey: Looking back, there was a momentary pullback in new arbitration claims at the outset of the pandemic, and then the last fiscal year had a strong surge in cases. The International Centre for Settlement of Investment Disputes (ICSID) set a record number of cases in the 2021 fiscal year, with the highest proportion in oil and gas, mining, construction, and electric. Commercial arbitration venues, such as the International Chamber of Commerce (ICC) and the London Court of International Arbitration (LCIA), also saw a robust increase in cases and nearly half the caseload was in the energy sector.

CD: What are some of the underlying causes of disputes arising in the energy sector? How big of a factor is the coronavirus (COVID-19) pandemic?

Knief: When it comes to looking at the underlying causes, it is important to note that the energy sector is particularly sensitive to changes from geological events, changes in politics or policy, and environmental regulations. These have huge potential for conflicts and disputes. For example, we have seen that in the mining sector there is a rising recourse to nationalism. Also, partly because of the
pandemic and the general economic slowdown, there have been revocations, cancellations of mining licences, changes in local laws, and export bans. This often leads to investment arbitrations. Looking at the numbers for 2020, of the 50 cases brought before the ICSID, approximately 20 percent concerned mining concessions, which is a record number of cases. It is hard to say how big of a factor the pandemic is because we cannot yet say how many disputes will unfold as a result. However, we expect a huge number of disputes to arise as a result of the pandemic, which has affected every level of the energy sector from exploration, production and refining to distribution and selling.

**Hernández:** The extent of the disputes related to the pandemic or to the effects driven by the pandemic are still unknown. In my view, there are three main underlying factors. The first is the fall in demand for many products due to lockdown. That has put stress on supply chains, often reducing value. The reduction has led to hardship, force majeure and other attempts to rebalance the economic position of business relationships and contracts. Second, the ensuing fall in end user prices for many energy products has brought tension in many contracts along the value chain. And third, the increased volatility in energy prices. We see disputes over licence obligations and royalty payments, for example, and disputes over long-term contracts where the value attached to the volume flexibility changes with price volatility.

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*Kent Phillips, Hogan Lovells, LLP*

**CD:** Have any recent, high-profile energy-related arbitration cases caught your attention? What lessons can the energy sector learn from the outcome of these cases?

**Phillips:** It is interesting because many of the biggest developments in the energy sector happen behind the scenes, yet some of the judgments we have seen in the English courts have caught the eye. One example is the *Travelport* litigation in London relating to material adverse change (MAC) clauses. This is one of those areas of a contract that parties are looking at; however, there is not a lot of reported
case law. Another area is Energy Charter Treaty (ECT) claims arising from renewables, solar in particular, and changes in tariff regimes. We are also seeing a lot of knock-on type disputes, joint ventures and treaty claims against governments, and there are more of those in the pipeline, which will provide additional lessons for the energy sector.

**Carey:** A few mining cases with environmental aspects have also attracted attention. Russia launched a US$4.6bn treaty claim against France for a gold mining project halted on environmental grounds, including pushback from environmentalists and indigenous communities. An iron ore project – a US$21bn arbitration claim – was recently cleared by an Australian court to proceed against the Western Australia (WA) state government, arguing a failure to assess the mine and the imposition of 40 conditions. These cases highlight the increased activism and environmental regulation and policy in high-stakes energy and mining projects that will need attention early and often during project development.

**Hernández:** In relation to renewable projects and feed-in tariffs, these cases in the EU may have seen a turning point after the judgment by the Court of Justice of the EU in the Achmea case. By stating that the dispute resolution clauses in bilateral investment treaties (BITs) among member states are not compatible with EU law, it can have far-reaching effects on current cases filed in those countries.

Further, the recent Termination Agreement that most member states signed on 5 May 2020 to terminate all intra-EU BITs, along with their sunset clauses, has confirmed those implications. Also, the European Court of Justice’s ruling in early September 2021 that the investor-state arbitration clause in the ECT does not cover intra-EU investment disputes potentially extends the impact of these decisions to the ECT and to non-EU investors.

**CD:** To what extent did pandemic-related challenges – such as lockdowns and shortages in labour and supplies – to
already complicated energy construction projects lead to international construction arbitrations? Do you believe economically distressed energy construction projects will lead to a wave of project failures?

Knief: It is hard to say whether economically distressed energy construction projects will lead to a wave of project failures. This will depend on how far companies have pulled out of prior investments, due to bankruptcy. We have also seen that a lot of projects have been and will continue to be significantly delayed. Yet, who bears the burden for the delay if the delay is pandemic-linked? Is there a uniform answer? No. There cannot be because it depends on what the individual contract says. From a civil law perspective, it may also be that the law applicable to a contract determines what happens in cases of force majeure, even if the contact remains silent on that point.
**Gonzalez:** Early on, we were advising parties on the initial impact of the pandemic and whether it fit within force majeure. The issue now is that we are living with the ever-changing impacts of the pandemic and still cannot predict how it will impact in new or different ways. Most contracts we see do not specifically deal with the impact, so it is up to the parties to figure out whether they can resolve these conflicts. If they are unable to resolve the conflict, we are going to continue seeing disputes. For example, there is already case law in the US where courts are taking harder positions on the enforceability-of-contract provisions post-pandemic and holding parties to their obligations. Those cases are very fact-specific, and we will have to see how it plays out related to energy construction projects. However, the notion that there will always be a free pass because there is a pandemic is not true in the long term.

**Carey:** The energy market dynamics have experienced tremendous disruption because of the pandemic, and projects with a longer time horizon, coupled with the substantial market uncertainty with demand and price all resulting in a longer-term period, will lead to more complicated quantum claims in these cases. There is also a larger gap of traditional energy resources that were not kicked off during the pandemic that are leading to high prices – commodity prices across coal, oil, gas, and so on, at this point in time. All these factors lead to more exposure, more risks and more considerations from an economic damage perspective affecting the energy industry.

**CD:** In terms of assessing damages or valuations in connection with energy-related arbitration, do any recent cases provide exemplars of best practices or shortcomings in approach or application?

**Hernández:** The award of the *Tethyan Copper v. Pakistan* case in 2019 partially used a ‘modern discounted cash flow (DCF) approach’, better known as a ‘real options approach’. It is essentially a slight modification to the traditional DCF approach for calculating damages to account for project

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*Fabrizio Hernández, NERA Economic Consulting*
managers’ option to modify project features in reaction to unfolding market circumstances. By making cash flow estimates depend on how managers adapt their decisions to changing scenarios, it can help the analysis of value consequences in the face of uncertainty about, for example, the availability of certain materials, potential shortages of labour or volatility in end user prices. Many capital-intensive projects, including construction projects, are built in phases, avoiding overly large upfront capital commitments if market conditions are uncertain. The real options approach in calculating damages can help reduce the number and complexity of scenarios that would otherwise be presented to tribunals.

**Gonzalez:** Parties on large projects have implemented a lot of technology-based project management, including, for example, use of electronic tagging of labour and materials on projects. This will continue to revolutionise delay analysis and analysis of projects. Historically, experts have relied on historical project documents evidence, such as meeting minutes. Now, thanks to technology, there will be real-time capability of capturing exactly what labour was onsite at any particular moment and a timeline of materials arriving on site. This will greatly impact how things will be analysed going forward.

**Carey:** Additional technology advancements will lead to greater reasonable certainty in economic damages. There are a few focus areas for historical damages analyses. First, damages analyses require the harmed party to mitigate damages. Second, with increased energy market dynamics, complications as to whether to conduct a damages analysis by looking back in time with the benefit of hindsight or just consider data available on the date of the breach, will increase. Third, careful attention to the interaction of prices, quantities and cost-related effects from a market is needed. Detailed economic analysis of the supply, demand and price-related effects to specific energy markets as a result of the claim is a very helpful approach to untangle the many issues that arise within all three areas.

**CD:** What advice would you offer to energy companies on evaluating and preparing strategies for pending arbitration proceedings? Are there any sector-specific nuances they should consider?

**Gonzalez:** With any new arbitration, it is important to do as much assessment of the case as possible upfront in the pre-arbitration phase, including mock trying the case in the first 90 days to get a real sense of the dispute, as well as putting some of the major issues to a pseudo-arbitration panel so a clear understanding of any strengths and weaknesses
can be ascertained. That kind of upfront preparation clarifies how the arbitration will be handled going forward. One of the energy specific nuances to consider is to select your arbitrators carefully. There are a lot of great arbitrators, however not everyone is suited for every kind of energy case, and saying that an arbitrator has experience in energy is too broad. There are numerous subspecialties and technical issues associated with energy cases, and it is important to ensure you take the time to select arbitrators carefully.

**Hernández:** It is important for parties to pre-assess the case as early as possible and to do it with an expert. It helps the case to view it from the expert’s perspective and with the expert’s understanding, and it also helps to know what issues are most relevant to the case expert and which are not. So, pre-assessing the case as much as possible is very good advice.

**Phillips:** With respect to experts, it is very important to include your experts in the pre-assessment phase. There is sometimes pushback from clients due to the frontloading costs, but it is absolutely critical to have your expert involved in your case formation. This means getting them involved not just when the memorial is due, but right at the start when you are putting your case theories together. This is an investment that is never wasted, especially in high-value disputes.

**Knief:** The importance of the selection of arbitrators is critical, especially for technical disputes within the energy sector. Even if you have an excellent case, you are setting yourself up for failure if your arbitral tribunal does not understand the technical issues involved in the case. It is key to have an arbitral tribunal that understands the issues, has seen these types of issues before and has a track record of resolving them. The selection of arbitrators is key.

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**Daniel E. González,**
**Hogan Lovells, LLP**

**CD:** In your opinion, how important is the right legal strategy to the arbitration process? In what ways can this increase
the chances of obtaining a successful award?

Knief: The legal strategy is the most important thing about running a case: it may make the difference between winning and losing. I was told very early in my career that every litigation has a motto, a key message. Initially, I did not really understand this, but the more experience I gain, the more I agree with it. ‘We are in dispute’ means something happened between human beings, and it is very important to understand the essence, the story behind what happened, and reflect that story in your submissions and explain the problem to the deciding body. It is not just a legal strategy. It requires an understanding of the facts, talking to the parties, talking to the witnesses, and getting to what is behind a dispute. Strategy is absolutely key.

Phillips: One of the most important ingredients in a successful strategy is the human factor. One thing that was missing over the last two years was the ability to sit with witnesses and potential witnesses in person. It is the comment made in the lift on the way down after the meeting or the remark made over lunch that leads to that understanding of what is behind the dispute and what might be driving it. Zoom calls are great, but there is a certain pace and structure and those chance remarks that happen in person have gone missing. And sometimes cases and strategies are built on lines of inquiry that come out of those chance remarks. It is more challenging than ever to be a lawyer putting strategies together given that we are without the benefit of in-person meetings.

CD: In your opinion, how important are expert witnesses to the arbitration process? In what ways can they provide support, add value and increase the chances of a successful award?

Gonzalez: Expert witnesses are critically important to the arbitration process, and the first step to increasing the chances of a successful award is knowing where to implement your experts. Experts

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Julie M. Carey, NERA Economic Consulting

Gonzalez: Expert witnesses are critically important to the arbitration process, and the first step to increasing the chances of a successful award is knowing where to implement your experts. Experts
are expected to be objective and impartial. Although experts are not advocates for the client, the arbitration system is moving toward having experts face off on issues – often referred to as ‘hot-tubbing’. Used correctly, hot-tubbing can be extremely effective, but it also presents new challenges. One such challenge is that sometimes technical experts may be ‘too comfortable’ with the process and start appearing as advocates rather than maintaining their role as impartial experts. It is a real tightrope that experts have to walk. It comes back, again, to preparing your case, including knowing whether your arbitrators are going to use hot-tubbing and working backward from that to identify experts who can deal with the technical information to either prove or disprove a particular technically complex issue and present that effectively in front of a tribunal.

Carey: Providing an independent expert opinion is core to the expert role and responsibility regardless of the arbitration format. Expert witnesses are not advocates. Their duty is assisting the tribunal by educating them with regard to their special area of expertise. In terms of particular areas of guidance to the tribunal, in complicated businesses with complex market dynamics and interrelated effects, experts can help by simplifying the complicated, explaining the inner workings of the industry and untangling any moving parts. In that way, experts can be a key part of a successful award.

CD: What is the outlook for arbitration in the energy sector? To what extent is post-pandemic economic activity likely to increase or decrease the number of arbitrations in 2022 and beyond?

Phillips: There will be a big uptick this year in terms of energy sector arbitrations. 2021 was a record year for disputes in Singapore, and even though post-pandemic economic activity may decrease arbitrations in 2022, I think there will be larger upstream of energy-related disputes, which is a product of COVID-19 turmoil, as well as a product of turmoil generally and structural changes. Look at oil majors, for example. Some oil companies are sticking to oil while others are going completely into renewables, which will lead to business disputes. Liquefied natural gas (LNG) disputes will likely increase in Asia given that long-term supply contracts are now coming through the process. Upstream oil and gas disputes are also very much alive in Asia, and we are still seeing coal disputes. Overall, arbitration has become the go-to dispute resolution mechanism in the energy sector for these types of high-value disputes. So, what might have gone to court 20 years ago in London, you now see in arbitration across the world in this sector. I am quite upbeat about the years ahead in the energy sector.
**Knief:** Fifteen years ago, everyone in Europe was involved in gas price review arbitrations. Now my impression is that, at least in Europe, most contracts will contain price formulas that are linked to spot market prices and include automatic adjustments. It will be interesting to see what disputes come from older contract models, which do not yet have those adjustments in place. There may be a revival in gas price reviews.

**Gonzalez:** In the Americas, we are going to see the same level of disputes in the energy sector that we have always had, if not higher. We have more in renewable areas, including several ongoing projects in solar and battery storage. We have discussed the challenges COVID-19 presented for disputes in the energy sector, however the fact that arbitration was very quick to adapt to remote hearings shows there has been a shift away from the courts and into arbitration. Many litigators sat stagnant for months due to the US court systems not being prepared for technology-based resolution. Arbitration, on the other hand, because most arbitrators were already used to dealing with multiple jurisdictions and doing many things remotely, moved much more quickly to a technology-based model, which has helped the energy sector move forward.

**Hernández:** The key word for the energy sector is decarbonisation. Decarbonisation is going to inform virtually all energy policies everywhere. And investing in renewables or in other decarbonisation-related investments is going to be a key priority for the sector and for governments to attract that kind of investment. We are seeing energy price spikes in many places. The temptation for local governments to deal with those spikes in ways that may reduce the credibility of the regulatory regime is something to watch for. The ability to attract billions of dollars’ worth of investments depends very much on the credibility and stability of those regulatory regimes, and that credibility, in turn, depends on the reliability of arbitration as a dispute resolution mechanism. Thus, the protection that investors perceive from the ability to resolve disputes through arbitration is a tool that can help attract investments.

**Carey:** We live in interesting times, and they are only going to get more interesting. A once-in-a-lifetime disruption, a pivot to an attempt to return to normal, rippling supply chain issues, a diverse energy sector, uncertain economic conditions, tremendous policy decisions and even emerging geopolitical risks will all shape the future of disputes within the industry. There are a lot of issues on the table in the longer term, but also a definite big bump in the shorter term. CD