

WATSON FARLEY & WILLIAMS

CLIENT BRIEFING

ENERGY DISPUTES HOW DOCUMENTATION AND DISPUTE PLANNING CAN HELP TO MITIGATE DISPUTE RISK

- MITIGATION OF RISK STARTS WITH PROPER DRAFTING OF TENDER DOCUMENTS AND CONTRACTS
- SOME INDUSTRY STANDARDS HAVE BECOME WIDELY ACCEPTED IN RECENT YEARS
- HOWEVER, SOME RISKS ARE ONLY KNOWN ONCE CONSTRUCTION WORK BEGINS
- FORWARD THINKING AND CUSTOMIZED DISPUTE PLANNING CAN BE AN EFFECTIVE WAY FOR RISK REDUCTION



Contractual Risk Allocation

It would be unfair to suggest that contracts for power projects are particularly prone to dispute when they are to the same degree as any other contract in a major construction project. Similar to other major construction projects, mitigation of dispute risk starts with proper drafting of tender documents and contracts. While supply contracts for offshore wind energy projects very much remain a made-to-measure product designed to accommodate the specific features and individual particularities of each project, the quality of documentation has generally improved in recent years and certain standards are now widely accepted, such as:

- Price certainty by using lump-sum price structures, subject only (excluding recourse to statutory law principles) to a limited number of specifically defined events in which additional costs may be claimed
- On-time completion protection by establishing guaranteed completion dates which – if missed – trigger liquidated damages (“LDs”)
- Strong protection of equipment quality by using a combination of fit-for-purpose warranties and agreed key performance indicators (“KPIs”), such as power curve and availability warranties
- Eliminating interface risk by consolidating contract packages (e.g. a balance of plant EPC wrap)

MITIGATION OF DISPUTE RISK STARTS WITH A CLEAR CONTRACTUAL ALLOCATION OF RISKS ON THE BASIS OF EVER DEVELOPING MARKET STANDARDS

While all of these features are available in the market to de-risk a project, a project sponsor/owner obviously remains free to pick and choose which features to employ, e.g. to avoid payment of excessive EPC-margins, but often such a decision corresponds with a higher risk of claims/disputes.

On top of that, in relation to some specific aspects of a power project, the full risk potential will only become transparent during the construction and operation phase; hence, while contract documentation will at best establish generic principles covering how to deal with and allocate these risks, such principles will remain subject to application and interpretation on a case-by-case basis, and will often refer to principles of statutory law to establish the “right” interpretation. Examples for such category of disputes would be:

- **Technology risk**

Technology risk remains a key source of disputes. Although many technologies have reached some degree of “maturity” in recent years, offshore wind technology in particular continues to evolve at a fast pace, introducing ever bigger wind-turbine models and foundation designs to the market. It is essential that the initial market entry of such technical evolutions is supported by strong contractual warranties.

- **Regulatory interface risk/certification**

Each supplier to a power project will have to confirm that its supplies/services will meet the requirements of applicable laws, permits and technical guidelines (such as those in relation to project certification). However, often these standards are generic, and specific (governmental) guidance on interpretation will only become available during construction. At this point, it is not unusual for such guidance to be perceived as “not customary”, “unreasonable” or “more cumbersome than comparable guidance received in other projects”. The project owner/sponsor (who handles the relationship with authorities and certification agencies) is then faced with the dilemma of having to argue both with authorities and suppliers to find solutions.

- **Dynamic design processes**

Only rarely is design completed before the contract is signed. Usually, design work will become part of the scope of work of supply contracts, and these processes need constant alignment with other contract packages and regulatory requirements. Where there is a conflict, additional costs can be significant, and often parties will disagree as to whether such costs could have been avoided by the supplier respecting a contractually agreed “design envelope” or simply notifying the owner promptly of any design update, or by the owner properly managing the interfaces between work packages. The productivity of wind farms can be substantially affected by wake effects resulting from adjacent projects. The possibility of such disruptions needs to be carefully investigated and the documentation should contain measures to exclude/mitigate these risks.

- **Adverse weather**

Working in a harsh offshore environment requires constant supervision of compliance with the operational envelope of installation gear as well as health and safety standards. Whether conditions are “workable” or not frequently requires on-the-spot judgement calls, which are not only subjective, but are often not properly documented. In addition, situations can arise in which several delays

are concurrent (what if weather conditions would not have allowed work, but at the same time important installation gear had been in repair?) or subsequent (what if work was first delayed by installation gear in repair and then (immediately) subsequently by adverse weather which could have been avoided, had the first delay not occurred?).

- **Coordination at construction site**

Usually, the project owner/sponsor (as “owner” of the site) will be required (by permits and statutory law) to coordinate access to and from the construction site, to ensure HSE compliance, and also to protect the physical integrity of the equipment on site (e.g. prevent vessel collision, prevent damage to cables by sub-sea operations of other contractors). Again, this requires on-the-spot judgement calls which may later become a matter of dispute. Typically, offshore contracts would mitigate such risks to some extent by using customary “knock-for-knock” indemnities, supplemented by a knock-for-knock-compliant insurance cover.

- **Multi-contracting**

Even though the supplier market offers consolidation of contract packages and (to some extent) EPC wraps, in reality many projects still use multi-contracting. While supply contracts would provide for a procedural framework for interface management (e.g. mandatory steering committees, notification requirements, etc.), it would usually be the ultimate responsibility of the project owner/sponsor to coordinate interfaces. However, often parties would afterwards disagree as to whether additional costs resulting from misaligned interfaces could have been mitigated by compliance with “early warning” obligations, etc.

FORWARD THINKING AND CUSTOMIZED DISPUTE PLANNING CAN BE AN EFFECTIVE WAY FOR RISK REDUCTION

Dispute Planning

Forward thinking and customized dispute planning can be an effective way for risk reduction. This should include thorough analysis, negotiations and a decision about which national law, court and procedure shall apply in case of disputes out of or in connection with the contracts yet to be concluded. However, the parties involved do not always use this opportunity in an adequate manner. At this stage, the parties are usually more focused on the successful conclusion of the respective contract, and they are therefore unlikely to sufficiently consider how to resolve potential disputes.

There are several options on how to handle contractual disputes, but the parties need to be aware of them and they need to reach an early decision regarding which option they will employ. Once the dispute has arisen, it is often too late.

- **Applicable law and venue**

Anticipatory dispute planning starts with the thorough examination which national law shall apply to the contracts yet to be concluded as well as the question whether the respective national courts or an arbitration panel shall decide in case of a dispute. For instance:

Due to closer connection and coherence, German companies usually subject the whole contractual relationship to German law. However, even if the respective agreement has been entirely negotiated between the parties, particular clauses (for example: lump sums for limited liabilities, guaranties upon first demand, penalties for delay) may be regarded as void according to the German legislation on General Terms and Conditions, which does apply in B2B relationships. This is particularly relevant if the parties have not sufficiently documented that such

clauses have been individually negotiated. For instance, instead of a limited liability (which has been agreed between the parties), German statutory law applies and this means unlimited liability.

The parties involved can avoid this unpleasant result with forward thinking dispute planning. It is possible (without “escape to Swiss law”) to submit the agreement to German law but to exclude only the application of the provisions regarding General Terms and Conditions. This solution, however, only works if, at the same time, the parties have agreed upon an appropriate arbitration clause in the course of the dispute planning. If the parties have chosen an unsuitable arbitration panel or the jurisdiction of a German court, the exclusion of the provisions regarding General Terms and Conditions is void and, as displayed in the example above, instead of a liability limited to a fixed amount, German statutory law with unlimited liability applies.

PROS & CONS OF
ARBITRATION NEED TO BE
CAREFULLY CONSIDERED:
CONFIDENTIALITY,
DOCUMENT
PRODUCTION RULES,
RISKS UNDER GTC
LEGISLATION

- **Choice of arbitration rules**

Similar “accidents” are likely to occur if the codes of procedure of the potential arbitration panels have not been adequately analysed and evaluated. Another example:

A strong argument for arbitration is the confidentiality of the arbitration procedure as opposed to the publicity of oral hearings in front of a public civil court. A company deciding to submit its dispute to an arbitration procedure, for example, at the International Chamber of Commerce in Paris (ICC), the German Institution for Arbitration (DIS) or the London Court of International Arbitration (LCIA) obtains the required confidentiality, but, however, can be forced by the rules of procedure of the respective arbitration panel to submit its internal correspondence fully, including all information saved electronically, to the arbitration panel as well as to the opponent as long as such correspondence and information seems relevant and is not privileged. This comprehensive duty to submit all documents does not exist under German procedural law. Therefore, parties involved in an arbitration procedure can be surprised and can have a clear disadvantage, especially if the opponent comes from an Anglo-American jurisdiction. These companies and their legal advisors are used to the duty to provide full documentation in civil law proceedings, know the dangers stemming from document production and usually will have taken precautionary measures which practically exclude them from the requirement to submit documents to the arbitration panel.

Forward thinking dispute planning will, therefore, consider to change the relevant procedure for the taking of evidence in the arbitration clause to the more restricted approach of the German procedural law or, at least, to Article 3 of the Rules of the International Bar Association (IBA) regarding the taking of evidence. These rules are a compromise between the Anglo-American and the continental European rules for the taking of evidence.

PROJECT PROGRESS MUST NOT BE IMPEDED BY PENDING DISPUTES: MEANS OF ALTERNATIVE DISPUTE RESOLUTION

- **Content of the arbitration clause**

If the parties have agreed upon an arbitration procedure, the arbitration clause needs to cover the whole procedure completely, which includes taking into account issues such as: Which arbitration panel is suitable (in particular regarding potential costs of the procedure)? Is it appropriate to name an ad hoc arbitration panel as an alternative to an institutional arbitration panel? Does it make sense to agree on fast-track arbitration rules? Is it advisable to agree on a provision regarding a multi-party arbitration panel in multi-contracting situations and what needs to be done if a corresponding "Arbitration And Third Party Notice Agreement" including all parties involved in the project cannot be agreed upon?

- **Alternative Dispute Resolution – ADR**

Dispute management will naturally seek to avoid any unnecessary escalation of conflicts. To prevent a standstill of the whole project, a fast and competent resolution of conflicts in particular during the construction phase might become necessary. Against this background, thorough dispute planning should always consider whether the installation of dispute adjudication boards (DAB) in parallel to the implementation of the project, referral of conflicts to a neutral expert or even mediation, e.g. within a multi-tier dispute resolution mechanism, is useful.

Interested?

Meet the WFW energy litigation team at the breakfast briefing "Energy Litigation" on 23 February 2016, 8:30 CET at our Hamburg offices at Jungfernstieg 51 (formal invitation to follow).

CONTACTS

Should you like to discuss any of the matters raised in this Briefing, please contact Dr. Malte Jordan, Dr. Sebastian Baum, Axel Löhde, Stefan Hoffmann, or your regular contact at Watson Farley & Williams.



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