

Arbitration Today in the Energy--Electric, Power Generation and Renewables Industries

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Introduction

Historically, arbitration was not a widely used tool for alternative dispute resolution in the traditionally regulated United States electric industry as compared to other industry and commercial sectors. However, most notably the use of arbitration began a significant expansion with the monumental and unprecedented transformation over the last several decades in this most critical and significant business sector of our economy.

With the restructuring of the industry into broad-ranging unregulated components, rapid internationalization, large scale mergers and acquisitions and, perhaps most importantly, recent technological advances principally in the renewable energy space, disputes are inevitably mushrooming in this new and changing world. As a result, many more sector participants are turning today to arbitration as the leading way to ultimately resolve the flourishing disputes that inevitably arise in the fast-changing world.

As the industry has transformed in recent years and the use of arbitration has blossomed, particularly as to competitive power generation, transmission, and renewables such as wind and solar at leading providers such as AAA and CPR etc., the issues that business planners and attorneys face in these arbitrations, as well as the tools that experienced successful arbitrators use to solve those, have a number of common themes. These themes deserve the attention of lawyers drafting arbitration clauses, litigators handling the cases and the business executives leading all sectors of the industry as it further continues to evolve.

The Nature of Arbitrations in This New World

Before discussing the planning tools that should be considered in arbitrations in the changing energy environment, a brief overview of the evolving nature of arbitrations in the industry is in order.

In the last 10-15 years as renewable energy resources, especially wind and solar, have penetrated the production (generation) mix in the industry, disputes have developed and many arbitrations have ensued, involving the developers and constructors of those facilities, and their counterparties as well as ultimate customers for the generated electric power. These disputes have arisen largely due to construction and operational issues, as well as power sales purchase and sale agreements with traditional utilities in what is still a relatively immature, but fast-growing sub-industry.

On the traditional and more mature power production front (coal, natural gas, nuclear, and oil), disputes are now flourishing in large part due to competitive cost challenges, issues associated with climate change, and the presence of new actors in the business.

Historically, electric generation assets were controlled by vertically integrated fully regulated utilities which also owned and operated the transmission and distribution systems that provide power to ultimate customers. This structure has changed significantly over the last 10-15 as a large segment of the electric generation in the US is now owned and managed by new companies—many of them equity investors and foreign entities-- unaffiliated with the utilities that still distribute power to end-users. In addition, there is another whole new arena in some parts of the country where larger utilities are managing and operating the distribution (so called, “wires in the street”) systems of the local utilities.

Inevitably, these transformations have introduced a whole world of new actors, all with differing economic interests and resulting in complex contractual arrangements and pricing mechanisms for electricity, creating fertile ground for disputes, and hence arbitrations (both domestic and international).

Similarly, disputes in the arena of electric transmission have flourished with the federally-mandated creation and promotion throughout the United States of independent power pools and system operators to economically manage and operate the high voltage electric transmission systems which, in many cases now, move all types of power from far-flung locations to end users. This has created a growing number of arbitrations involving the rules of those independent entities and their participants across the country.

Getting the Arbitration Provision Right at the Outset

The development of new contractual relationships in the rapidly changing industry, particularly in the renewable resources arena, whether involving construction of facilities, power purchase agreements, or transmission contracts provides golden opportunities to get the arbitration process in underlying commercial contracts right at the outset, and preserve the future course of the relationship of the parties in the industry.

Historically, contracts in the electric industry have not always adequately dealt with issues that come up in arbitrations, leaving much to the vagaries of the litigation process and not to the best and most efficient use of the alternative dispute resolution process, contrary to what business leaders desire in the first place when making the deals. More importantly, there seems to have been a lack of recognition that the disputes that can very easily develop often involve millions, if not billions, of dollars in dispute, and getting the process correct at the outset is an important part of the business planning process.

Drafters of newly developing commercial arrangements need to deal with these historical realities, and make sure their new contracts address a number of critical items from the beginning. The contract drafters should talk to attorneys who have actually litigated arbitrations and deal with important considerations up front such as: do the contracting parties want a administered or ad hoc arbitration; what kind of arbitrator(s) their clients actually want; whether

a tri-partite Panel or sole arbitrator should be involved; whether the arbitrators should have special expertise and what is it; and finally, should an eventual arbitration itself be structured as much as possible long before any dispute arises and the “honeymoon” of the early days of the business relationship come to an end.

As to arbitrator selection, it is important to make sure that the process the drafters develop reflects business needs, and the reality of the universe of arbitrators available. If a contract requires too specific and inflexible requirements for subject matter expertise (e.g. “10 years of working in the wind plant construction and operation field” which this arbitrator author has seen in a contract), it is quite likely that the arbitration formation process will become unduly complicated and expensive, and ultimately might result in the appointment of arbitrator(s) who do not satisfy the parties. The selection criteria should be as flexible and broad based as possible, while specifying that expertise as seasoned arbitrators is a most important criterion with certain added, but not restraining, industry specific requirements if the parties think that is important.

One of the ways to make sure that the desired appropriate expertise is brought to the table is to give serious consideration to using a tri-partite Panel with party-appointed neutrals from both sides with the specific required expertise, but then providing for an experienced arbitrator, not necessarily with the same narrow credentials, to be the Chair of the Panel. While it might appear at first glance that using three arbitrators instead of one might increase costs, in actuality that should not be the case compared to the overall costs of a complex arbitration for the business and its attorneys. And, most importantly, using three arbitrators will provide a level of risk avoidance of a “wild card” result with one arbitrator—the kind of risk that business leaders are always interested in avoiding in any setting.

Finally, it is probably a good idea early on to set in the contract arbitration clause the precise parameters that the parties want—before they have a dispute—as to how they want any resulting arbitration to unfold. Serious consideration should be given to the reach of discovery (e.g. extent of document production and a limit on depositions for efficiency and cost purposes), the permitted length of the arbitration hearing and limits on the overall timing of the process. These issues can become a barrier to efficient and timely resolution of disputes—contrary to the desires of business executives—if left open for the arbitration process itself when counsel and the parties are litigating. In other words, set the stage early in order to achieve the ultimate business objectives of the parties involved.

Administration of the Arbitration Process

Whether the arbitration process is well defined in the contract or needs to be set ultimately as part of the arbitration process once a dispute is underway, parties need to recognize that arbitrators who specialize in the energy field have come, in recent years, to use important tools to make the process work best. For example, in many energy arbitrations, the use of prepared written direct testimony submitted prior to hearings (including from the inevitable experts who will be involved in these kinds of cases) followed by cross-examination has become a regular feature in industry arbitrations to save time and costs. The technique is adaption of a tool that most energy litigators are familiar with from the regulatory world, and it seems to work its very best in this industry. Not only does it save time and expense, but it assures that the arbitrators

start the hearing process with a fuller understanding of the issues at play, and that most often results in better decisions in the end by fully informed arbitrators in complex and technical disputes.

Another tool to consider using in the administration of an energy arbitration is to how to handle the hearing testimony of experts. While expert reports will probably have been submitted to the arbitrator(s) in most cases, some arbitrations are now featuring a concept of “hot tubbing” being applied to experts. In that device, the experts appear together on the stand and “debate” their conclusions. While this technique seems to work particularly well in construction and environmental disputes, it probably is not adaptable to economic and contractual issue cases in this industry. However, it is worth considering in any energy dispute.

Another way to produce good results in arbitrations in this industry is make sure that even if detailed parameters cannot or have not been set in the contract for development of the case, is to make it clear right from the outset that speed and efficiency are important, as key components of the business goals of the contracting parties. That will guide litigators to understand what their clients have in mind when the process is set. Along these lines, it almost always is important to have inside corporate counsel and/or a key business representative involved from the beginning of an arbitration (right from the preliminary conference) to make sure the case is developing in the way the client desires. Good experienced arbitrators are now requiring that kind of corporate presence right from the beginning of the case and continuing throughout the arbitration.

Finally, to assure that corporate objectives are achieved and the contract is followed, it is most important to select arbitrators who have a proven reputation of acting in a diligent, and efficient way to keep cases on track, as well as creativity to structure the case in order promote efficiency and fairness to all parties. Inside and outside counsel involved in arbitrations can and should seek, and pursue, as much background information as possible on potential arbitrators to carry out that part of the mission.

Variations on the Usual Themes

While many of the disputes in the electric industry are commercial and/or pure contractual in nature, it seems that many of the arbitrations in the sector are now occurring in unique settings. These types of cases raise a number of unusual considerations. For example, many power pools and regional transmission organizations in the industry have dispute resolution procedures in place that refer non-regulatory issues to “normal” arbitrations (through administrative bodies or as self-administered arbitrations). These cases present opportunities for parties to those types of matters to use arbitrators with experience in the transmission and power production fields, who also have an understanding of the regulatory tariff world that overlays the disputes. Typically, parties in those types of matters will not find many set parameters for arbitrations in the clauses involved, but their counsel can be guided by some of the considerations above as to the conduct of cases. One other unique feature of these cases, particularly of some regional transmission organizations is that results of the arbitrations under the Federal tariffs involved can be subject to review by the Federal Energy Regulatory Commission. That is another consideration that should be borne in mind as arbitrators are selected in order to assure they have reputations as

experienced and knowledgeable arbitrators who can establish an adequate record and produce a well-reasoned award in the event of such a review at the Federal level.

Conclusion

The bottom line is that with the rapid ongoing transformation of the electric industry in recent years, particularly with the gathering impact of climate change, it is the right time to step back and think hard about recognizing the benefits of arbitration (cost savings, confidentiality and preservation of business relationships going forward) and designing the alternative dispute tool to meet the needs of industry participants: old, new and those evolving. Arbitration can be a valuable tool in easing the industry transformation and maintaining good relationships.

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