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Seoul ADR Festival Recap: Energy Market Disputes in an Almost Post-Covid World

Sameer Thakur (Peter & Kim) · Tuesday, November 15th, 2022

On the second day of the 11th Asia-Pacific ADR Virtual Conference, the KCAB, the South Korean Ministry of Justice, the ICC Court of Arbitration and UNCITRAL hosted a panel on the state of the energy markets in 2022.

The panel was moderated by Dr. Wolfgang Peter (Senior Partner, Peter & Kim) and the panelists included Annette Magnusson (Co-founder, Climate Change Counsel), Aisha Abdallah (Partner, ALN Kenya), Dr. Matthew Secomb (Partner, White & Case), Steffen Lund (Investment Director, Business Lolland Falster), Todd Wetmore (Partner, Three Crowns) and Steven P. Finizio (Partner, WilmerHale). Dr. Peter noted at the outset that the panel aimed to comprehensively evaluate the state of the energy industry: from the difficulties and disputes arising from a transition to renewables, disputes arising from traditional oil and gas projects to renewables projects, to specific commentary about the current state of the energy market in Europe and the Asia-Pacific.

The State of the Energy Industry: Tensions Between Short-Term Requirements and the Long-Term Vision

Ms. Magnusson underscored that the International Energy Agency (the "IEA") has described the current situation as the "*first truly global energy crisis*" whose impacts will be felt for years to come. She described a central tension for states that are seeking a transition to renewable energy sources: their urgent short-term needs, namely industrialization and electrification (and the methods required to best fulfil them), are not aligned with their long-term goals of sustainability or decarbonization.

She noted that, while there have been considerable investments in clean energy and renewable sources, the current level of investment (USD 1.3 trillion) is simply insufficient to meet the target of Net Zero Emissions by 2050, which requires almost triple the amount of investment (USD 4 trillion). Ms. Magnusson also acknowledged that the question was not just about the amount of investment, but the destination of that investment, considering investment into the developing world for clean energy seems to have flatlined.

Ms. Abdallah pointed out that the cost of moving to renewable sources of energy is not similar across the world. Countries in Africa that have not yet fully industrialized (and where millions of people still do not have access to electricity) cannot be expected to industrialize solely by using renewables. She pointed out that no country had managed to do so — all countries to date have industrialized using fossil fuels. Ms. Abdallah highlighted that concurrent with their sustainability obligations, African nations have developmental obligations to their citizens that they must prioritize.

Therefore, the extent and gravity of the short-term needs further complicate an already tricky debate. Ms. Abdallah and Ms. Magnusson also agreed on the need for lack of funding for renewables projects in Africa (and other parts of the developing world) to be corrected as soon as possible.

On that front, Mr. Lund commented from his experience in developing renewable energy projects in Lolland-Falster in Denmark: a region that produces 5-7 times the energy it consumes. He flagged location as a key business consideration when planning green energy projects: it was helpful to base these projects near major cities with sustainable growth potential to both raise funding and to ensure the project's long-term sustainability.

Disputes Arising from the Development of Offshore Wind

The panel then discussed offshore wind, a form of renewable energy that has seen tremendous growth recently, particularly in Asia. Dr. Secomb discussed the various phases of an offshore wind project — the establishment phase, the construction phase, the operation phase and the long-term use phase — and the kind of disputes that can arise.

- Risks at the establishment phase include the constantly developing regulatory regimes, where changes (or risk of changes) in regulations can negatively impact transactions, as well as issues connecting offshore wind projects to the larger project grid.
- Risks at the construction phase involve all of the risks that are associated with construction of any large-scale project but are exacerbated by the difficulties of offshore construction, such as weather and lack of availability of the necessary vessels. Due to the risk and complexities involved, it is unlikely for one EPC contractor to undertake the full project — leading to multiple contractors and higher risk.
- Risks at the operation phase involve warranty claims, which are heightened, as well as increased interface risks due to the construction contractors and operations & maintenance contractors generally being different entities, unlike what is the case with other major projects.
- Long-term risks involve risks of disputes from changes in governmental regimes governing these projects, such as reduction in subsidies. These could become investor-state or other disputes. There are also risks of disputes arising from the environmental impact of these projects on local communities.

The Energy Crisis and Its Impact on the European and Asian Markets

Mr. Wetmore provided comments on the gravity of the energy crisis being faced by the European markets, the response of European Authorities and his analysis of the possible implications of their response.

He began by reminding the audience that, since early 2021, European gas prices have faced unprecedented volatility, at some points reaching more than 500-1,000% of normal gas prices, mostly caused due to interruptions in supply of gas from Russia. This price volatility has had a tremendous impact on European industry, leading to a 70% reduction in fertilizer production, a 50% reduction in aluminum production and a prediction from Goldman Sachs that 40% of Europe's chemical industry faces a permanent rationalization of production in Europe.

Faced with these challenges, European authorities sought to provide a three-pronged solution: (1) a new LNG price benchmark that would accurately reflect the price of LNG transactions in Europe, which the current benchmark (TTF) that is indexed to the main European gas exchange no longer does; (2) a temporary price cap until the new benchmark is developed; and (3) the creation of a single European gas purchasing consortium, which would allow European companies to consolidate their purchasing power. He remarked that some have stated that these interventions could have a dampening impact on prices as it sends a signal to the market that higher prices would not be tolerated. At the same time, there is a risk that artificially low prices could lead to lower supply and lower investment into development of new infrastructure, as well as disincentivizing gas conservation.

Mr. Finizio commented on how the last few years have fundamentally changed central assumptions that were the basis of conversations about the LNG market in Asia. For instance, it was normal to expect that there would be a continuous increase in both demand and supply for LNG in Asia. This growth in demand was expected despite a concurrent growth in renewable energies as several major economies in the region moved from coal to LNG, which was seen as the cleaner fuel. However, with the significant increase in prices (and the reduction in supply) and the possibility of European buyers seeking more LNG, it is possible that there would be a reduction in demand for LNG in the future — which could have negative consequences for the environment if there is a resultant switch back to coal.

Conclusion

The energy market is at a crossroads: the need to further develop and transition to renewable sources is keenly felt, but due, among other reasons, to the pandemic and the interruptions in supply arising from the military conflict in Europe, fulfilling short term needs has become a priority.

There undisputedly will be an increase in the number of arbitrations in the sector, whether they be gas price review disputes or disputes of other kinds.

As Dr. Peter noted, the added complexities the panelists described show that arbitrations in this sector are more akin to three-dimensional chess than regular chess. Some of these complexities are inherent to the industry, and some are a result of the complicated mechanisms that are utilized to determine a price for energy commodities.

More coverage from Seoul ADR Festival is available here.

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