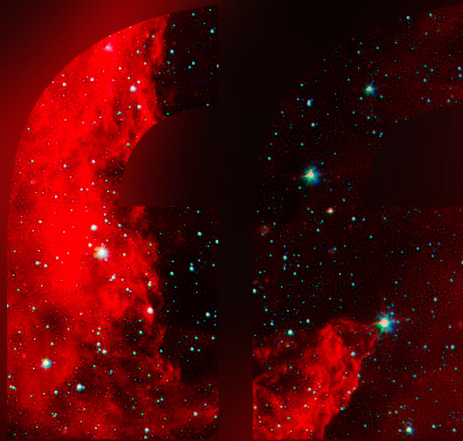
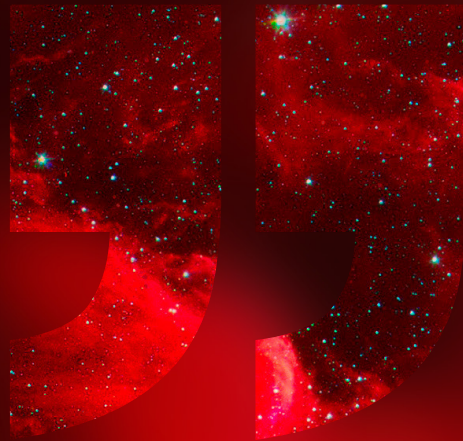


C L I F F O R D

C H A N C E



**ENERGY
ARBITRATION
TRENDS 2023**



— THOUGHT LEADERSHIP

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ENERGY ARBITRATION TRENDS 2023

The fallout from Russia's invasion of Ukraine, as well as energy transition issues such as decommissioning and regulatory change, all present significant challenges for energy sector participants. As governments and commercial parties alike seek to adapt to these developments, we expect to see a continued rise in certain types of disputes.

Investment treaty claims relating to renewables/ carbon phase-out

The investment treaty regime is in a state of flux. With the investment treaty landscape having been conceptualised before the emergence of the climate crisis, most treaties are silent on environmental issues. At the same time, States are under pressure to regulate in order to mitigate the effects of climate change and comply with new international obligations assumed under, *inter alia*, the Paris Agreement.

As States transition away from fossil fuels (particularly coal) to renewables, a wave of investment treaty claims has followed. Investors are most commonly seeking to rely on investment treaty protections accorded to (i) long-term fossil fuel investments made in reliance on guarantees from the State, which the State now wishes to rethink due to the climate emergency, and (ii) renewables investments made in reliance on subsidies and other investment incentive schemes that have been subsequently amended or eliminated altogether.

Decommissioning

Decommissioning is recognised as an integral part of the energy transition journey from fossil fuels to renewable forms of energy. It is invariably a costly and hazardous activity often undertaken in hostile environments. As major players look to decarbonise their operations by transitioning from fossil fuels to renewables, ageing oil and gas assets are often transferred from major oil and gas operators to new, often smaller (sometimes under-resourced) operators. This operator-transitioning is a critical point in the asset's lifecycle, and comes with many challenges and complexities for both outgoing and incoming

operators, including of a technical, economic, operational, regulatory and environmental nature. Some challenges faced by incoming operators in the short to medium term include ESG sensitivities while continuing the production of fossil fuels to meet market demands, maintaining or improving sustainable performance of ageing assets, and decommissioning risks, while maintaining value chains and maximising value in their newly-acquired assets. One significant challenge faced by outgoing operators in many jurisdictions in the medium to long term is exposure to ongoing trailing liabilities for decommissioning of the asset and operations, which can apply long after their divestiture of the asset, and can expose outgoing operators to significant financial, regulatory and reputational risk, litigation and liabilities. These challenges call for advanced planning and investment by both incoming and outgoing operators in a bid to manage and mitigate those risks.

A robust decommissioning strategy and a detailed implementation plan are critical to energy transition. The ultimate objectives of decommissioning are an efficient, safe and environmentally sustainable outcome. To achieve those objectives, some factors that any credible decommissioning strategy must take into account (irrespective of the sector involved – be it oil and gas, mining, nuclear, onshore or offshore) include: (a) the need for early planning from the nascent stage of a project throughout its entire lifecycle; (b) the multifaceted and multidisciplinary nature of decommissioning, involving the relevant regulatory framework, safety and environmental issues, mitigation strategies, financing and corporate considerations; (c) evolving technologies; (d) the expense involved, with no readily discernible financial returns for stakeholders; and (e) the relevant liability

regime and risk exposure, to name a few. We will necessarily see an increase in arbitral disputes regarding decommissioning as we see significant fossil fuel projects approach cessation of production globally, and as operators and States grapple with the need to complete decommissioning in a comprehensive and efficient manner.

Long-term contracts

Energy transition-related policy changes and the Russian-Ukraine war have caused a number of parties to long-term energy contracts – for example, in relation to power, gas or coal – to invoke their rights under contractual frameworks in the past year. In light of developments such as the German nuclear phase-out, issues with French nuclear power plants, gas price spikes in Asian markets, coal phase-out plans across Europe as well as the share of renewable energy increasing fast, to name just a few, this trend will likely continue. Significant developments in markets and regulatory changes are also causing disruptions to long-term relationships. The significant value of long-term contracts in the energy market means that the coming years will certainly see last year's trend continuing, with perhaps an even broader reorganisation of the energy sector causing the death or restructuring of many formerly stable long-term relationships between stakeholders.

Regulatory change

As States regulate to address the climate crisis, the ensuing regulatory changes can collide with investor protections under investment treaties. With treaties such as

the Energy Charter Treaty (ECT) "blind" as to whether a protected investment is fossil fuel or "clean" in nature, investment treaty cases such as *Rockhopper v Italy*, in which the investor was awarded substantial damages after Italy banned coastal oil exploration, have made headlines.

In order to reduce protections for fossil fuel investments, States have moved in two directions. First, agreement in principle on reform of the ECT has been reached, pursuant to which fossil fuels may be carved out from the treaty's scope of protection, while at the same time, further forms of renewable energies may be brought within its scope. Second, several States have announced plans to withdraw from the ECT outright, arguing that it does not go far enough to address their climate change obligations.

As we move forward, States may seek to further refine their treaty obligations beyond those under the ECT so as to provide themselves with broader freedoms to legislate away from fossil fuels and towards renewables, as well as protection from claims perceived as challenging their climate policies. Meanwhile, investors in the energy sector are likely to continue to litigate in order to protect their interests in the energy transition but may also seek to refocus their activities more on renewables. Despite the uncertainty regarding the future of the ECT and its scope of protection, investment treaty arbitration, particularly under the ECT, continues to be a widely used form of dispute settlement between States and foreign investors.



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