

The elephant in the room dispute resolution processes for RE IPP programme introduction



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Now that the successful bids from Phase 1 of South Africa's Renewable Energy Independent Power Producer (RE IPP) Programme have reached financial close, project companies overseeing the development of these projects need to turn their minds to the administration of the contracts underpinning these projects.

One matter with the potential to create issues is where there are differences between the dispute resolution procedure set out in the Power Purchase Agreement (**PPA**) that project companies are required to enter into with Eskom Holdings SOC Limited (**Eskom**) and the dispute resolution procedures negotiated in the construction and operation contracts (generally Engineering, Procurement and Construction (EPC) and Operation and Management (**O&M**) Contracts) between project companies and EPC and O&M Contractors.

The dispute resolution procedure set out in the PPA provides for litigation of disputes in the High Court of South Africa. In contrast, the dispute resolution procedure negotiated in many of the EPC and O&M Contracts under the RE IPP Programme provide for arbitration of disputes, commonly under the International Chamber of Commerce (**ICC**) Rules of Arbitration or the Arbitration Foundation of South Africa Rules.

This paper discusses the dispute resolution processes under the PPA and EPC and O&M Contracts, along with issues that may arise in disputes under the aforementioned contracts under the RE IPP Programme that, due to the nature of the dispute or the relationship of the parties, have not been resolved at any intermediate stage in a dispute resolution process and proceed to the final stage of litigation or arbitration, as relevant. Although it is acknowledged that some types of disputes that may arise in respect of the RE IPP Programme projects may be more appropriately resolved by alternative dispute resolution procedures (such as disputes involving valuations, defects and other technical issues relating to the facility which may more appropriately be resolved by an independent expert), these matters are not the subject of this paper.

Why provide for arbitration under the EPC and O&M contracts?

The question may be asked: why don't all EPC and O&M Contracts provide dispute resolution procedures that mimic the procedure set out in the PPA?

Issues identified in PPA drafting

Firstly, a number of issues have been identified with the dispute resolution processes provided under the PPA.

The standard "internal referral" process (outlined below) does not provide for service of a notice of dispute to define and crystallise the nature of the issues for discussions between the parties. The provision for the dispute to be referred to the liaison officers or "other designated executives from each party" is undesirable as it leaves the nomination of personnel open-ended and may allow the parties to manipulate a dispute by delaying the appointment of relevant officers to deal with the dispute at the initial stage.

The PPA also provides the additional “fast track” process of dispute resolution using an independent expert. There have also been a number of issues identified with this process including that:

- it is not always clear in what circumstances the fast track dispute procedure is to be applied under the PPA
- there is no provision for the method of appointing the expert
- the expert’s discretion is wide-ranging with only limited checks and balances
- there is no provision to appeal the decision of the expert.

As the PPA is non-negotiable, these identified issues cannot be addressed or mitigated under the PPA by the parties. As a result of the non-negotiable nature of these issues, parties have been reluctant to adopt the dispute resolution processes set out in the PPA in the EPC and O&M Contracts.

Preference for arbitration

Given that many of the parties involved in the RE IPP Programme projects are international developers, contractors and suppliers, there has been a strong preference for the parties to use arbitration (rather than litigation) as the preferred dispute resolution mechanism. This preference is based on a range of reasons such as:

- the enforceability of the arbitration award on a near-worldwide basis, as opposed to the more limited recognition of foreign judgments
- finality of the arbitration award, as opposed to the avenues of appeal that exist in litigation
- specific expertise of arbitrators in particular subject matter areas
- privacy due to the confidentiality of arbitral proceedings and awards
- time savings
- a broad acknowledgement and understanding of commonly used arbitration rules such as the ICC rules
- in some cases, the perception of increased impartiality due to resolution of the dispute occurring outside of a country-specific judiciary.

Recognition of a judgment can be uncertain where either or both jurisdictions are not party to formal reciprocity agreements such as the *Hague Convention on the Recognition and Enforcement of Foreign Judgments in Civil and Commercial Matters*, or are not nominated as reciprocal jurisdictions in their domestic legislation. In some cases it may be that the issue of enforcement can only be resolved by further litigation.

Dispute resolution procedure – PPA

If a party to the PPA defaults in the performance of its obligations and a dispute arises “in relation to or in connection with any aspect of” the PPA, as noted above the two dispute resolution procedures that may apply under the PPA are “internal referral” and “fast track”.

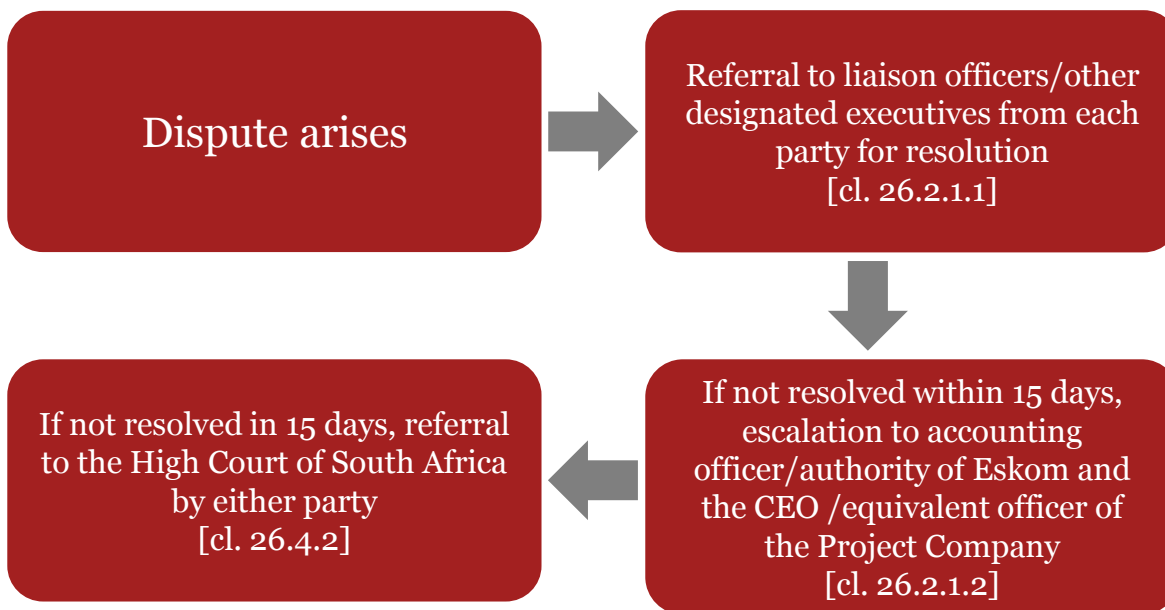
Internal referral

If a dispute arises, either party can refer the dispute to a meeting of the liaison officer, or other designated executives from each party who are

- actively involved in the ownership or lease of the project site and the ownership, construction, operation and maintenance of the facility
- sufficiently authorised to resolve the dispute.

Should the parties be unable to resolve the dispute within 15 days of this referral, either party may refer the dispute for a decision by the accounting officer/authority of Eskom and the CEO/equivalent officer of the Project Company. The parties and their employees and representatives must use reasonable endeavours to resolve the dispute and must not be delayed by negotiations or any other informal procedure that the relevant representatives may adopt. If the dispute is not resolved within 15 days of referral, the dispute may be referred to litigation in the South African High Court by either party.

The following flowchart provides a diagram of the dispute resolution procedure under the PPA:



Fast track procedure

The “fast track” procedure required to be followed in specified circumstances under the PPA results in referral of a dispute to an independent expert. This procedure is notable in terms of the risks posed to a Project Company if it is deemed to have failed to cooperate in the fast track procedure.

Under this fast track procedure, the expert is expressly afforded the same powers as a judge of the High Court of South Africa, unless restrained by law from exercising such power or ordering such relief. Should the Project Company fail to cooperate with the independent expert, for example, on the basis that the Project Company considers that the subject of the dispute was caused by the Contractor under the EPC or O&M Contract, as relevant, and the independent expert believes that such default or omission prejudices the adjudication procedure, the independent expert can order that the Project Company forfeits the right to continue to participate in the adjudication, the outcome of which is final and binding.

General dispute resolution procedure – EPC and O&M contracts

Escalating dispute procedure

EPC and O&M Contracts generally provide a staged dispute resolution procedure that commences with internal discussions for a specified amount of time aimed at resolving the dispute prior to commencing formal proceedings – An example of such a procedure is set out below.

The dispute must first be referred to the Project Company's representative and the Contractor's representative, who then have a specified period in which to resolve the dispute. After the specified period has elapsed, either party may refer the dispute to an executive panel comprised of the CEO or equivalent of the Project Company and the Contractor. After considering the issues, the executive panel may then issue a written decision that is binding upon the parties. If the executive panel does not resolve the dispute within a specified period, or agree upon alternative procedures to determine the dispute, then either party may commence arbitration.

The completion of this staged escalating procedure is a condition precedent to arbitration. Only once one of the parties has attempted to follow the procedure (and the procedure has failed to resolve the dispute) can the parties agree to resolve the dispute by way of arbitration.

The elephant in the room?

The misalignment between the PPA and the EPC and O&M Contracts or procedures may present an issue if a dispute arises:

- under an EPC or O&M Contract where the relevant Contractor alleges default by the Project Company
- under the PPA where Eskom alleges default by the Project Company.

and the Project Company alleges that its default in either scenario is due to an act or omission of a third party that is not a party to the specific contract under which the Project Company is alleged to have defaulted, but that third party is actively involved in the project and has entered into a separate agreement with the Project Company (eg Eskom in example 1 and the EPC or O&M Contractor in example 2).

In such a situation the Project Company will be faced with two issues:

Recourse from the defaulting party

The third party is not obliged to participate in a dispute resolution procedure under a contract to which it is not a party. If a third party is not willing to negotiate its liability or participate in the dispute resolution process by consent (notwithstanding that it may have contributed to a default of the contract by a party to that contract), the party seeking to join that third party will need to begin a sometimes protracted process of requiring joinder.

Continuing obligation to follow dispute resolution procedures

As the party with concurrent obligations under both the PPA and the EPC and O&M Contracts, the Project Company will be contractually obliged to follow the dispute resolution procedure under both contracts through the escalating stages that are a condition precedent to initiating formal proceedings, be that litigation or arbitration.

Issues arising when a dispute under the EPC or O&M contract is due to a default of ESKOM.

Hypothetically, if Eskom, through its own act or omission, has caused the Project Company to default on one of its contractual obligations under the EPC or O&M Contracts, as Eskom is not a party to these contracts it cannot be compelled to participate in the dispute resolution procedure due to the lack of privity of contract.

Whilst the ICC rules, for example, allow for joinder of parties under article 7, this is only possible where the parties consent to be joined or are also subject to ICC arbitration agreements. No rule allows for the joinder of a party, however relevant to the dispute, that is not a party to an ICC arbitration agreement.

Action under the PPA

If Eskom's act or omission that caused the Project Company to default under the EPC or O&M Contract can also be characterised as being the cause of "any dispute arising in relation to or in connection with any aspect" of the PPA, the Project Company could initiate a dispute under the PPA against Eskom. The dispute would then continue through the procedure set out by the PPA until it was resolved between Eskom and the Project Company.

Action under the EPC or O&M Contracts

If a Contractor sought to enforce its contractual rights against the Project Company and to initiate the dispute resolution procedure under the EPC or O&M Contract by serving notice of dispute upon the Project Company, given that it would not be able to join Eskom to the arbitration without consent, the Project Company should seek a stay of procedure to prevent the dispute from proceeding to arbitration until it is able to resolve the dispute with Eskom.

If it is clear that the Contractor will not agree to a stay or otherwise cooperate, the Project Company should apply pursuant to section 3(2) of the Arbitration Act No. 42 of 1965 for an order that the dispute should not be referred to arbitration. To be successful in such an application, the Project Company must show "good cause" as to why such an order should be made – in such a case this could be argued to be due to the futility of the arbitration process without the involvement of Eskom. An application under this section would not place the Project Company in default of the EPC or O&M Contracts, provided that the relevant contract contains the standard provision that, notwithstanding any dispute resolution procedure set out in the contract, allows a party to apply to a court of competent jurisdiction to seek urgent or interim relief.

If, through its own act or omission, the Contractor caused the Project Company to default on its obligations to Eskom under the PPA, the Contractor (which is not a party to the PPA) cannot be compelled to participate in the resolution of the dispute under the process set out in the PPA due to the lack of privity of contract.

Action under the EPC or O&M contracts

If the act or omission leading to the default under the PPA can also be characterised as a default causing a dispute to arise under the EPC or O&M Contract, the Project Company could initiate the dispute resolution procedure under the relevant contract by giving the Contractor notice of the dispute. The dispute would then continue through the escalating dispute resolution process until resolved.

If the dispute resolution clause is broadly drafted such that the dispute resolution process will apply to "any dispute arising" under the EPC or O&M Contracts, a practical solution may be to have the Contractor consent to the dispute in respect of the PPA being dealt with under the EPC or O&M Contract, as relevant. However, if the dispute resolution clause is more narrowly drafted or if the Contractor's act or omission cannot be characterised as being a breach of its obligations under the EPC or O&M Contract, it will mean that the act or omission in question could not be the basis of a dispute under the relevant contract. In these instances, resistance by the Contractor to follow the dispute resolution procedure set out in the EPC or O&M Contract may be difficult to challenge.

Action under the PPA

If the dispute with Eskom regarding the Project Company's alleged breach of the PPA proceeds to the High Court of South Africa, the Project Company could apply to the court pursuant to rule 13 of the Uniform Rules of Court for a joinder of the Contractor as a third party to the proceedings.

Joinder of the Contractor is not without its difficulties. Section 6 of the Arbitration Act No. 42 of 1965 provides a party to an arbitral agreement the right to apply for a stay of a third-party notice served under the Uniform Rules of Court, as service of this notice and any purported litigation falls outside of the agreed dispute resolution procedure under the EPC or O&M Contract. If an application for stay was made by the Contractor, the Project Company could raise arguments as to why a stay should not be ordered, such as the futility of the dispute resolution procedure or the risk of multiple proceedings in order to satisfy the court that the dispute should not be determined by arbitration in accordance with the relevant contract.

Even if the Contractor is successfully joined and a judgment is entered against the Contractor, as discussed above the Project Company may encounter problems in enforcing the South African judgment in the Contractor's jurisdiction due to specific rules of recognition of judgments between countries.

What steps can parties take to mitigate these issues?

Importantly, the Project Company should aim to maintain a strong commercial relationship with the Contractor and Eskom. In addition to allowing disputes to be quickly identified, this should also assist all parties to remain engaged and receptive to practical resolutions discussed in this paper, such as agreeing to joinder or consolidation of claims. EPC and O&M Contracts should also include clauses that provide for consolidation of disputes.

Robust contract administration will also assist in order to avoid disputes arising in the first place, or to resolve disputes at an early stage to avoid costs and delays.

Given that processes under both the EPC and O&M Contracts and the PPA provide for a stage that involves discussions between the parties' representatives, it is critical to ensure that the representatives nominated for these discussions have the sufficient decision-making authority allocated to allow them to negotiate and agree on a resolution to the matter.

Finally, given that the potential issues outlined in this paper all carry a risk of incurring significant cost and delays, all parties should be aware of these matters as risks to be avoided during the development and operation of the project and of the imperative for cooperation.

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