

THE LAW OF BIOMASS
—Resolving Disputes: Preplanning—

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I. Overview. As with any development, a biomass project can become the subject of litigation in state and federal courts. Litigation can involve any of the topics discussed in previous chapters, as well as a host of other disputes that may develop during the life of the project. Anticipating what disputes may arise and proactively planning for their resolution, whether through litigation or otherwise, will increase the odds of a favorable result. This chapter outlines some issues to consider that may help circumvent problems and discusses potential areas of dispute in the development and operation of a biomass project.

II. Proactively Drafting Against Disputes. The many contracts associated with a biomass development project, including technology licensing, supply/offtake agreements, and construction-related agreements, can provide ample grounds for litigation. Retaining experienced counsel to assist with the drafting of the contracts, however, can minimize future disputes and, most importantly, provide a clear roadmap for resolution should a dispute over contract performance arise. Although contracts may specify that alternative dispute resolution (“ADR”) be used either as a prerequisite to the initiation of a lawsuit or as an alternative to litigation in state or federal court, ADR, depending on how it is drafted, can be just as costly as litigation. Therefore, careful consideration should be given to the pros and cons of ADR, as discussed later in this chapter. As the biomass industry matures, contracting parties are discovering that they need to look not just at the financial terms of their commercial agreements, but at the default and cancellation provisions as well. Unfortunately, a myth exists that the language at the back of a contract (default provisions, limitations of liability, attorneys’ fees, etc.) is just “boilerplate.” In fact, these contractual provisions can be the heart of a dispute, so a developer would be wise to make sure that these areas receive some attention by an experienced attorney.

A. Output and Requirements Clauses in Shutdown Mode. A hypothetical supply/offtake contract would provide for a feedstock supplier to sell, and the biomass facility to purchase, a set amount, an amount within a range, the total supplier output, or the total offtaker requirements of the feedstock for the eventual production of electrical power. This contract will often contain estimates of supply and demand and may require one of the parties to provide updated estimates during the term of the agreement. However, in most cases these estimates are for planning purposes only and are expressly not binding on either party. A pertinent question often asked is, if the biomass facility is bleeding cash due to the high cost of the biomass production and a good-faith decision is made to shut down operations, can the biomass facility inform the requirements seller that its requirements are now reduced to zero and inform the output buyer that its output is now reduced to zero, and then walk away? Surprisingly, the answer may be “yes,” based on judicial interpretations of section 2-306(1) of the Uniform Commercial Code (“UCC”).

Section 2-306(1) of the UCC says contracts that measure the quantity sold by either the requirements of the buyer or the output of the seller are enforceable, provided that the amount of promised product is not unreasonably disproportionate to any stated estimate or, if there is no stated estimate, to the normal supplier output or offtaker requirements. However, some courts have allowed buyers to reduce in good faith their requirements to any amount, including zero. These cases demonstrate the importance of protecting sellers by requiring minimum purchases from the buyer; otherwise, in the event of a buyer shutdown, they may find themselves without a customer and without a remedy. Similar analysis has been applied to output contracts when the seller’s output, for good-faith reasons, drops significantly below the expected output, *i.e.*, estimates of output should not be considered a binding obligation because forcing the facility to stick to an obligation to sell the estimated amounts may compel the seller to make inefficient business decisions that were not contemplated when the contract was signed.

B. Insecurity and Grounds for Reassurance. In the past, default provisions were often not negotiated or discussed when supply and output agreements were executed. Even before default though, a buyer

or seller who has reasonable grounds for insecurity is entitled to adequate assurance of performance under section 2-609 of the UCC. If one contracting party has reasonable grounds for insecurity, it may suspend performance pending assurance of performance. A failure to provide adequate assurance of performance within a reasonable time (usually 30 days or less) amounts to a repudiation of the contract, and the aggrieved party can choose to continue to wait and hope for performance or act as though the contract was breached.

Reasonable grounds for insecurity is usually a question of fact. If one party suspends its own performance because it has reasonable grounds to feel insecure, that party is still subject to the risk that its belief will be found to be unreasonable, and that party will then be in breach. It is important to note that the grounds for insecurity need not arise from circumstances directly related to the parties or the contract itself. If the market price of a commodity is rising, the buyer may be justified in seeking assurances of performance from the seller even though the seller did nothing to cause the buyer's insecurity.

Requesting adequate assurance of performance is a powerful tool because the counterparty is then in a position in which it must provide that assurance or risk having the contract be deemed anticipatorily repudiated. It also contains many traps for the unwary when used indiscriminately or when contracts are drafted without regard to its existence. The law is clearer on what will not be considered adequate assurance than on what will be. For example, when one party to a hedging contract demanded assurance that the counterparty would deliver the product, the counterparty responded by saying it would deliver "if the contract were later determined to be legal"—that is *not* adequate assurance. Also, contractual remedies may be broader than the UCC damages.

C. Attorneys' Fees Clauses. Many people insert attorneys' fees clauses into supply and offtake agreements without much thought. In some states, all attorneys' fees are automatically (regardless of the contractual terms) transformed into "prevailing party" clauses. In other words, even though the contract might say, "Seller gets attorneys' fees if it has to sue," the state law may interpret that clause to mean, "Winner gets attorneys' fees." Of course, many clauses are drafted that way anyway. If the parties omit an attorneys' fees clause, the "American rule" applicable in most states in most commercial contracts says each party bears its own fees, regardless of a win or a loss. Thus, in the absence of an attorneys' fees clause, neither party can expect the other party to pay its fees.

III. When to Involve Litigation Counsel. Frequently litigation counsel is first retained only when litigation becomes inevitable, either because a party has been sued or a dispute has reached the stage at which a party determines that a lawsuit must be filed. Involving litigation counsel before that stage is reached, however, can reap numerous benefits. Litigation counsel can advise on ADR procedures that can avoid the costs involved in litigation in state or federal court and can ensure that actions taken during the early stages of a dispute do not prejudice any ultimate litigation. Furthermore, gaining an early understanding of the merits of any potential litigation can help resolve the dispute in an appropriate manner.

In selecting litigation counsel, a potential client should locate counsel that specializes in the types of legal issues that are involved in the dispute—environmental or technology rights, for example—and that has a deep knowledge of the industry. Retaining counsel with industry expertise can greatly increase the odds that litigation will be successfully resolved.

IV. Finding the Appropriate Forum: State and Federal Courts, Regulatory Agencies, and ADR.

A. Forum. Forum selection is critical. In disputes not involving a contract (which usually specifies the forum), the most appropriate forum depends on the contract, the issues, the amounts in dispute, and the parties. If possible, the benefits and disadvantages of each available forum should be given careful consideration

before one is chosen. Options may include state or federal court, administrative litigation before various regulatory agencies, or some form of ADR, such as mediation or binding arbitration.

When a dispute involves issues of federal law or parties from different states, federal court may be an option. Given the plethora of federal and state regulatory agencies, litigation before various regulatory agencies is often a prerequisite before any litigation in state or federal court. If the dispute concerns a contractual matter, the contract will frequently specify the forum in which the litigation must be filed and which law should govern the dispute. The contract may also specify that some form of ADR must be used, either before or instead of litigation in state or federal court. Even if not required to engage in ADR pursuant to the terms of an existing contract, the parties may choose to engage in ADR after the dispute develops.

B. ADR. Experienced parties do not automatically choose court resolution or ADR for all their business relationships. Instead, they evaluate the advantages and disadvantages of each available method and choose the one that is best for them in each situation. ADR can consist of mediation and arbitration or other novel methods created by the parties. Mediation is a form of negotiation guided by a neutral mediator. Experienced parties may decide during contract negotiations to specify by name in the contract language an industry expert to serve as the mediator, should mediation become necessary. Mediators have no authority to resolve the parties' dispute. Their role is to help the parties communicate settlement offers and other information. Because the communications between a mediator and a party are not disclosed unless the party gives permission, mediators are well suited to give candid and objective assessments of each party's position in a dispute. They may also help the parties formulate a negotiation strategy that leads toward settlement.

Arbitration is a form of dispute resolution in which a private party, the arbitrator, is given authority to resolve the parties' dispute. The parties can agree to the rules governing the arbitration process, which may be similar to the rules of court governing litigation in state or federal courts. Some ADR providers (such as the American Arbitration Association) publish sets of arbitration rules.

Alternatively, a dispute resolution board ("DRB")—a panel of persons experienced in the industry—can be assembled, usually at the beginning of the parties' relationship. Its use is generally limited to major construction projects. The DRB members become familiar with the parties and the project and are available to respond to disputes that arise. Because they are chosen by both parties for their expertise, DRB members' opinions may have considerable weight. Sometimes DRBs are given quasi-arbitral powers to decide disputes.

The chief benefit of ADR is that the parties are usually able to choose their own mediators, arbitrators, and DRB members. This gives parties the opportunity to select someone who has expertise in the industry and the issues involved in the dispute. By contrast, judges are simply assigned, giving the parties little control over who will decide the dispute.

Other aspects of ADR to consider include the parties' control over the rules of the process, which may speed a just resolution (or may deny a party a fair opportunity to present its case); the private nature of ADR proceedings, which can protect sensitive business information (or remove a threat of publicity that might make a party more willing to settle); and the finality of arbitration decisions, which saves the costs of appeal (but could leave a party disadvantaged by an erroneous decision that cannot be challenged effectively).

V. Noncontractual Disputes. Litigation may arise in a variety of areas during the development and operation of a biomass project. Like any large development project, a biomass project may generate local opposition. Although many people would welcome a biomass project as an environmentally friendly alternative energy source that can generate new local jobs, others may view the development differently. When outreach,

education, and consensus-building break down, opponents of a project may resort to litigation. Litigation can lead to costly delays, and litigation strategy often focuses on allowing a project to continue development pending resolution of the claim.

A. Permitting. The permitting process provides many opportunities to challenge a project. Project opponents can delay or even prevent a project by objecting to the permitting decision, and if local opposition is particularly strong, the permitting agency may refuse to grant a permit. The permit applicant can challenge the denial of its permit through the agency's administrative appeal process, and then, if necessary, to the appropriate courts, and so can the opposition. Proper defense of a permit decision begins by actively participating in the permit process and ensuring that the local government or state agency follows all steps and has all relevant information necessary to support the grant of the permit. The decision of the permitting agency is then substantially easier to defend during the appeal process.

B. Environmental Review. Several states have broad environmental review statutes that provide fertile ground for challenges to biomass projects. For example, the California Environmental Quality Act ("CEQA") requires any governmental agency in California that makes any type of discretionary decision that potentially has an impact on the environment to conduct an environmental review and may require that an environmental impact report be prepared before approval of the project. Washington has a statute similar to CEQA, the State Environmental Policy Act ("SEPA"). Like CEQA, SEPA allows agencies to deny projects with significant unmitigated adverse impacts if feasible alternatives exist. If federal agency approval is needed, the agency itself may be required to comply with a number of federal mandates that can give rise to a potential citizen suit under the Administrative Procedure Act ("APA"). Among other federal requirements, the federal agency may need to comply with the National Environmental Policy Act, the Federal Land Policy Management Act, and the Endangered Species Act. APA cases are generally limited to reviewing the "record"—the information considered by the agency at the time it makes a decision. Consequently, the key to defending such actions is to participate early in the decision-making process and make sure the agency's decision is adequately supported by the information in its possession. Should the agency's approval action be deemed arbitrary and capricious or otherwise contrary to law (a common litigation tactic used by citizen groups to stop or delay a project), the permit or approval may be invalidated and sent back to the agency for further consideration, resulting in substantial delay.

C. Post-Construction Challenges—Nuisance. Post-construction challengers must demonstrate that the operation of the biomass project violates some state or federal law and that a private lawsuit is authorized. Preeminent among these challenges is a common-law nuisance lawsuit on the theory that the project operator is using its land in a manner that "substantially and unreasonably" interferes with a nearby property owner's ability to "use and enjoy" his or her own property. For biomass projects, odor may be a potential issue. Plaintiffs may allege that the project creates an unreasonable amount or intensity of odor. Nuisance suits generally seek monetary damages for compensation and, in rare cases, may be awarded injunctive relief (*i.e.*, temporarily shut down the plant) to abate the nuisance.

D. Design, Engineering, and Construction Disputes. Construction contracts usually include detailed provisions allocating risks and costs during the construction process. These provisions are intended to anticipate problems and provide agreed-on resolutions so that disputes can be avoided. However, sometimes disputes arise despite the parties' best efforts. Major construction projects are complex, involving large numbers of participants and project milestone schedules possibly spanning several years, all of which generates large volumes of paperwork. Construction disputes are correspondingly complex, which makes them expensive to analyze and resolve. All parties have an incentive to avoid the expense of full-blown disputes if they can. For this

reason, construction contracts should contain provisions intended to make the dispute resolution process more efficient and more predictable.

E. Insurance Coverage. Most businesses have a package of insurance policies that cover them and their employees against liability for bodily injury and property damage claims by third parties outside the organization. These policies are commonly known as comprehensive general liability (“CGL”) policies and cover the organization and its employees against claims for slander, invasion of privacy, misrepresentations, etc. CGL policies may also cover the organization for automobile liability and certain employment practices (such as employment discrimination or wrongful discharge). Insurance coverage is a valuable tool because it usually provides both defense coverage and coverage for indemnity. Often the defense coverage is not limited by the amount of insurance available to pay claims.

Property insurance can protect the business against losses to its own property from natural or unexplained causes (such as lightning, fire, flood, earthquake, or collapse) and provide indemnification against such losses. Businesses can also be covered under a third party’s insurance as a result of a contractual requirement or business arrangement. Larger businesses will also typically have a form of directors’ and officers’ liability insurance. Other types of specialized coverage include coverage for business interruption, pollution liability, and difference in conditions.

Almost all insurance policies for business require a form of notice whenever there is a claim or a potential situation that might result in a claim. The specifics of the notice provisions must be followed carefully by the company to properly initiate the duties of the insurance carrier for the claim.

F. Intellectual Property Litigation. Biomass projects are heavily dependent on proprietary technology, patents, licenses, and trade secrets. Litigation can arise either from infringement by third parties or from the need to defend against other parties claiming infringement.

VI. Conclusion. By the time you have read to this point, you may be discouraged by all of the challenges discussed. It is important to know that most of these pitfalls can be avoided by careful drafting of the underlying contracts to the project. If a problem cannot be definitively resolved by the terms of the contract without dispute resolution, it is important that the contract’s language gives the parties a clear and cost-efficient path toward the problem’s resolution. If you, as the developer, go into this process with a plan for dealing with these problems, should they arise, then you will have more success with your business than those who rushed in without adequate forethought. But remember that regardless of whether the project is prospective, fledgling, or mature, teaming up with a law firm experienced in the biomass industry will provide the proper support at any stage.