Arbitration Clauses in Gas Supply Agreements

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One of the core elements of long-term Gas Supply Agreements are price review provisions (also called price reopener clauses), which allow parties to review the price of the gas during the life of the agreement. The importance of such clauses lies in the long-term nature of the agreements (often up to 30 years) and the changing nature of the markets. The price is usually defined in a formula and often, particularly in older agreements, linked to the oil price. The par-ties might also agree on a specific source for the oil price to which the gas price will be linked, e.g. **Platt's Oilgram Report**, a daily report that covers market changes, market fundamentals and factors driving prices.

Price Revision Clauses

To avoid regular and difficult price renegotiation, parties to a long-term contract normally seek a mechanism that allows prices to follow pre-defined market movements. A price formula is de facto a "simple" price revision clause.

In a formula, the gas price will normally be linked to a benchmark. Indexes exist, e.g. the Henry Hub index or Platts Indexes. A European buyer may prefer a more accurate benchmark, e.g. the European Bulk prices "CIF NWE Basis ARA" [2] Parties may also want to link the prices to the market for alternative sources of energy, such as fuel oil or coal.

For long–term contracts, the standards of calculation and the format of the publication may eventually change from time to time. The contractual equilibrium between the parties might need to be re-established after structural changes in the underlying market. This is the reason why "price review provisions" are common in long-term gas supply agreements.

The main difficulty is that changes of circumstances are difficult to foresee at the drafting stage. If at a certain point the parties' views on price revisions differ and settlement negotiations fail, the

agreement usually calls for arbitration, the most accepted dispute resolution mechanism in the energy sector.

In such a situation, however, not all changes of circumstances will require the same solution. Technical issues or the suspension of the reference publication must be quickly addressed by the parties or by an independent panel to allow the contract to continue to operate. The question as to whether the economic circumstances have changed and the formula no longer reflects the market as initially intended by the parties, will obviously take longer and be more difficult to assess. Similar complexity will arise with regard to the importance of alternative sources of energy. Who could have predicted that the US market share of "shale gas" would increase from 1% in 2000 to over 20% today?

Adjustments of Price Formulae

If an arbitral Tribunal is called upon to decide whether the price formula requires adjustment, it may well have to revise the price formula itself. Given the complexity of price formulae in gas supply agreements the parties to a gas supply agreement may find that the tribunal will exceed the parties' suggestions and pleadings, and finally render a ruling on a formula that does not fit the expectations of either party. This has happened, e.g. in Atlantic LNG Company of Trinidad and Tobago v Gas Natural LNG SPA, [3] where the arbitral tribunal came up with a hybrid formula, which contained elements from both parties' formulae, but where the result of which was not desirable for either party. Most recently, on 27 June 2013, an ICC arbitral tribunal upheld RWE's claim and adjusted the price formula contained in its contract with Gazprom Export. RWE informed the **press** that the tribunal awarded RWE a reimbursement for payments made since May 2010, and adjusted the purchase price formula by introducing a gas market indexation, which, according to the tribunal, reflected the relevant conditions on the gas market. The authors do not know the pleadings of the parties and the contract formula, but it seems that the arbitral tribunal linked the price to an index for spot gas prices, although the parties had contractually agreed to link it to the oil price.

Arbitration Clause

One of the mechanisms to bypass such a problem is the selection of the "right" arbitrator(s), with extensive knowledge of the gas supply market, its prices and the functioning of price formulae. Where an arbitration clause calls for a three-member panel, neither party has full control over the appointment process. However, it is not recommended to insert in the arbitration clause specific requirements an arbitrator must fulfil, as the downside may be more detrimental to the resolution of the dispute than the problem of arbitrators exceeding the parties' wishes.[4] In fact, if the parties wish to maintain some predictability with regard to the outcome of the revision process, they may draft their arbitration clause in such a way as to **limit the arbitrators' powers** to adjust the price formula. Another option to define the boundaries of the arbitral tribunal's jurisdiction with regard to the revision process would be to exclude the application of hybrid formulae. Another approach from the point of view of costs would be to include one of the so-called "**baseball arbitration**" or "**pendulum approach**" clauses. In baseball arbitrations (or final offer arbitrations) each party submits a proposed monetary award to the tribunal. After the final hearing, the tribunal chooses one award from those submitted, without modification. The pendulum approach obliges each party to

provide their "best guess" of the true value or adjustment required. The arbitrators then select the suggestion of one party.[5] In both cases, arbitral tribunal is bound by the parties' pleadings and positions and cannot apply a different formula.

It should be noted that it is more difficult for a **three-member tribunal** to agree on a hybrid formula, departing from the pleadings of the parties, than it is for a sole arbitrator. Given the financial outcome of price revisions, which are often very significant because even small changes can generate huge financial implications, a three-member tribunal is more appropriate to balance the parties' expectations.

Disputes under a gas supply agreement may be unrelated to price revisions. They may instead involve, e.g. the determination of the quality of the gas. Other international trade industries adopted specific arbitration rules for claims limited to quality and/or condition (e.g. the Arbitration Rules of the Grain and Feed Trade Association (GAFTA) and the Association of Oils, Seeds and Fats Associations (FOSFA), where arbitrations are often completed, with an award rendered, within weeks. [6]

In the gas industry, cases limited to claims on quality and condition might favour other mechanisms, more apt to satisfy the parties' needs and expectations for speed and costs. For such disputes, a sole arbitrator and/or expedited procedure might be more appropriate. Also, minor questions related to price revision, e.g. the adjustment of the formula to changes in indexes or publication, which eventually will occur in long-term contracts, need to be addressed quickly and efficiently to allow the contract to operate with clarity.

The question, therefore, is how can both objectives be met in one single gas supply agreement, i.e. utilising a three-member panel for price revision disputes, and sole arbitrators for expedited proceedings on claims relating to quality, conditions and any other disputes under the same agreement. The authors have encountered situations where the parties drafted separate arbitration clauses in the same agreement: one "general" arbitration clause calling for a three-member panel that applies to price revision processes; and one or more clauses, calling for a sole arbitrator to determine disputes over specific issues.

It is clearly in the parties' interest to submit "smaller" disputes to a sole arbitrator who can generally render an award in a more cost and time effective manner. Careful drafting of multiple arbitration clauses in one single gas supply agreement is recommended, as conflicting arbitration clauses may generate jurisdictional disputes. Multiple clauses may lead a party to have to pursue two arbitral proceedings, one for the determination of the cause of the claim, and one for the consequences of the claim.

Expedited Procedure and Article 42 Swiss Rules

Article 42(2) of the Swiss Rules of International Arbitration (Swiss Rules) call by default for expedited procedures if the aggregate claim and counterclaim (or set-off defence) does not exceed CHF 1 million. [7] In expedited procedures parties are entitled to a single exchange of briefs, a single hearing

for the examination of witnesses and oral pleadings, and for a sole arbitrator unless the arbitration agreement provides otherwise. The award shall be rendered within six months from the date on which the Secretariat transmits the file to the tribunal. [8] The advantage of Article 42 is evident: parties need not draft different arbitration clauses to address different types of disputes, but can declare the Swiss Rules applicable and rely on Article 42(2). However, the case will only be referred to a sole arbitrator if the parties have not agreed otherwise in the arbitration agreement. The parties may opt for a sole arbitrator when they already know about the type of dispute. If they do not agree, the case will be submitted to three arbitrators as provided in their agreement, but with the advantages of the expedited procedure.

Summary

When drafting arbitration clauses for long-term gas supply agreements, due regard should be given to the arbitrators' power to alter price formulae. Due to potential problems of hybrid formulae in price revisions and their significant financial consequences, it is recommended to agree on a three-member tribunal.

As under gas supply agreements, there may be price revision disputes and other disagreements, a faster and a less costly procedure would better serve the parties' interests. The Swiss Rules of International Arbitration provide an interesting tool in Article 42, if parties refer to such Rules: it helps prevent jurisdictional disputes which might occur if multiple arbitration clauses are inserted into one single gas supply agreement.

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2. Published in Platt's Oilgram Report, where NWE stands for "North West Europe", ARA for Amsterdam, Rotterdam, Antwerp Range.

3. Holland / Ashley, Natural Gas Price Reviews: Past, Present and Future, Journal of Energy & Natural Re-sources Law, Vol. 30 No. 1 2012

4. The parties could also in the arbitration clause require the arbitrators to consult a specific agreed institution for specific matters.

5. Polkinghorne, The Paris Energy Series No. 2, Predicting the Unpredictable: Gas price re-openers, White & Case, June 2011.

6. Section 2(a) of the Rules of Arbitration and Appeal of FOSFA requires the arbitration be proceeded within 14 consecutive days of the appointment of Respondent's arbitrator.

7. Approximately EUR 820,000 as of April 2014.

8. De Vito Bieri / Favre Schnyder, Swiss Rules of International Arbitration, Commentary 2ed. edition, N 8 to 13 of Art. 42.