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GENEVA
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Skills Training Workshop
"Help, I have been Assigned to a
Gas Pricing Arbitration!"

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Young ICCA and YIAG Skills Training Workshop: "Help, I have been Assigned to a Gas Pricing Arbitration!"

Report by Angela Casey, Associate at LALIVE, Geneva

The Young ICCA/YIAG joint Skills Training Workshop took place in Geneva at the premises of the Geneva Chamber of Commerce, Industry and Services on 1 December 2017. Mindful of both the challenges that junior practitioners may face in the early years of their practice and the importance of energy-related arbitration disputes, the organisers of the event entitled the Workshop "**Help, I Have Been Assigned to a Gas Pricing Dispute!**". More than seventy young students and arbitration practitioners including inhouse counsel and experts, from various jurisdictions braved the cold and snowy weather to attend this exciting workshop.

Catherine Anne Kunz, Counsel at **LALIVE**, member of the workshop's steering committee and a YIAG regional representative welcomed the audience and thanked the event's generous sponsors (the **Swiss Chambers' Arbitration Institution**, the **Geneva Chamber of Commerce, Industry and Services**, **LALIVE** and the **International Council for Commercial Arbitration**).

Caroline Ming, Executive Director & General Counsel of the Swiss Chambers' Arbitration Institution, pointed out that this event was an excellent opportunity to reconnect with old and new friends in the arbitration community and at the same time gain an insight into a complex and intriguing topic.

The afternoon was structured into three panels and provided an overview of everything a young international arbitration practitioner needs to know to start working on a gas pricing arbitration.

The views expressed concerning how various price review provisions are interpreted, or the validity of particular methodologies, is based on the experience of the individual participants and does not necessarily represent the views of the firms or companies they represent.

FIRST PANEL: Introduction to Long-Term Gas Supply Agreements

The first introductory panel was moderated by **Nhu-Hoang Tran Thang**, Associate at **LALIVE**, Young ICCA Co-chair and part of the workshop's steering committee. The panellists were **Angélica André**, Associate at **White & Case LLP** and **Augustin Barrier**, Associate at **LALIVE**. This first panel gave a brief overview of Gas Supply Agreements ("**GSAs**") between gas suppliers and buyers, and explained why GSAs are special and complex contracts.

Augustin Barrier launched the discussion with a personal story from the time he was assigned to his first gas pricing arbitration. The partner told him about an interesting case with sophisticated parties that had a disagreement on a price, which was based on oil. Augustin – initially relieved because it was not another construction case – later realized that it was worse than construction law, as he only saw complicated mathematical formulas he could not make sense of. But eventually he figured it out. Gas pricing arbitration is complex at the outset but, at the core, it is a rather simple dispute which involves economics and market-related data analysis.

Angélica André explained the contractual framework between the buyer and the seller. A GSA is a long-term contract, often concluded for a duration of 10, 15 or even 30 years. The Parties' interests differ significantly. The seller – often a State or State-owned company – wants to obtain the highest gas price possible to recover its investment in the infrastructure necessary to extract and transport the gas. For its part, the buyer's main business is to secure the distribution to end users, while making a reasonable margin. Traditionally, as a general rule is that the seller bears the price risk and the buyer bears the volume or quantity risk, as the latter undertakes to offtake a minimum agreed quantity of gas each year, and/or each month.

Ideally, the parties to the GSA share the risks between them and make sure that the contract strikes a reasonable balance between their respective interest over its duration. To the amusement of the audience, the panel compared a GSA with a marriage: both parties are committed to one another and are supposed to get along with each other "for better or for worse".

The first two panellists moved on to discuss the GSAs' price formulae and their varying degree of complexity: since GSAs involve the undertaking by the buyer to purchase and offtake significant quantities of gas over a very long period, the price revision clause is of utmost importance. It indeed allows either party to request a revision of the contract price after the lapse of a certain period of time, or upon the occurrence of pre-determined triggering events.

The "take-or-pay" clauses, also typical of GSAs, relate to the agreed contractual minimum quantity and are called this way because the buyer undertakes to pay for a minimum quantity of gas, whether the



buyer actually offtakes it or not. In either situation, the buyer has to pay the agreed minimum contractual quantity at the agreed contract price. In this sense, the meaning of take-or-pay clauses is closer to “take and pay or not take and pay”.

GSAs govern long-standing commercial relationships. Hence, even after the occurrence of a dispute, the parties’ relationship shall continue. During arbitration proceedings, the performance of contractual obligations is usually not suspended, and the parties are commonly trying to find an amicable solution to their price revision dispute in parallel. This explains why it is frequent that arbitral proceedings in gas-pricing disputes are stayed to allow the parties to conduct settlement negotiations.

Most commonly, the contractually agreed gas price may be revised when economic circumstances change (one or more typical so-called “triggering events”). Without such revision, the price of the gas would remain fixed throughout the entire contractual term (*i.e.* for 10, 15 or even 30 years) regardless of external developments. But not any change in market circumstance will allow the parties to request a price revision. Certain changes may be addressed through alternative means, such as temporary discounts on the gas price or by way of flexibility in the minimum quantity the buyer has to offtake and/or pay (*i.e.* increase/decrease clauses). A price revision is, as a rule, only warranted if the change is expected to last for a certain period of time. The price revision is a contractual tool to enable the parties to renegotiate the price of the gas according to certain pre-determined principles and to restore the contractual balance that was in place when the parties entered into the contract.

There are several reasons why arbitration is the preferred forum for such disputes. First, these disputes often involve State interests. A buyer from State A would not be keen to resolve its disputes with State B through the court system of its contractual partner. Second, the contracts, in particular the price formulae, are highly confidential.

The panel’s discussion was closed with a question from the audience on whether it is possible to end a GSA amicably. Both panellists indicated that they had not seen the termination of a GSA without an arbitration.

SECOND PANEL: Price Revision Triggers

The second panel was moderated by **Catherine Anne Kunz**. The panellists were **Bregje Korthals Altes-van Dijk**, Partner at **De Brauw Blackstone Westbroek**; **Jorn van Beckhoven**, **Shell Global Litigation** and **George Anstey**, Expert at **NERA**.

Catherine Anne Kunz opened the discussion by asking: what does a client need to do when it intends to request a price revision? **Bregje Korthals Altes-van Dijk** explained that the starting point of a price revision is the trigger criteria set forth in the price revision clause which often requires a “significant” “change” in “circumstances”.

George Anstey explained that the reason why there have been so many gas pricing arbitrations is because the market conditions changed significantly in the last two decades. In the original industry structure, the market was fragmented, and every regional monopoly sold its gas in its region. The prices were regulated by governments and the demand for gas had grown consistently because of the gradual shift from coal to gas.

Historically, the prices of gas in Europe were linked to the prices of oil and oil products. As explained by **Jorn van Beckhoven**, the Brent index, a global benchmark to determine crude oil prices, was often chosen as one of the indices to which the price of gas was tied. Over time, several important changes in the energy market altered the pricing mechanisms in long-term GSAs, leading to a shift from oil-indexation towards increasing natural gas indexation.

The emergence of trading hubs was an important change in the gas market. Trading hubs allow the buyer to trade and sell gas on a short-term basis. This effectively means that a buyer has an accessible way to dispose of the surplus accumulated as a result of its Take-or-Pay obligation. Selling such surplus gas is preferable to storing the gas due to the limited storage capacity and costs.

Another significant change was the growth in Liquefied Natural Gas (“LNG”) supply. Technically, LNG is not a new source of energy, but rather a liquefying process of the gas to make it easily transportable over long distances. This widened the markets available to buyers. For instance, while a number of European countries could previously only import gas from Russia, the emergence of LNG enabled them to broaden their sources of supply to countries further away like Qatar. This naturally resulted in the diversification of sources of natural gas and a profound modification of the global gas market.

At the end of an engaged discussion, the panel concluded with the remark that one of the interesting issues arising in gas pricing arbitrations is that the tribunal must decide on a revision of the price for a determined period of time in the past, looking backwards, and that it is not supposed to take into account the current conditions of the market or any market fluctuation which occurred after the period relevant to the dispute. The tribunal must in consequence disregard the fact in a given situation that, were it to decide accounting for today’s circumstances, the contract price would already be much lower and might not entail a price revision.

Third Panel: Price Revision Arbitration under LCIA & Swiss Rules

The third and final panel was moderated by **Guillaume Tattevin**, Partner at **Archipel**. The panellists were **Marion Paris**, Associate at **Lévy Kaufmann-Kohler**, **James Freeman**, Partner at **Allen & Overy** and **Valentina Bonetti**, Senior Associate at **The Brattle Group**.

The panellists launched the session by postulating that a gas price arbitration is an arbitration with a twist.

Guillaume Tattevin opened the discussion and asked Marion Paris what the arbitrator's concerns typically are in gas pricing arbitrations. **Marion Paris**, who participated in several gas pricing arbitrations as a secretary to the tribunal, explained that one of the concerns of the arbitrators is often the complexity of the case and of interpretation issues that arise in connection with a price revision clause.

With respect to the economics, tribunals either rely on the parties' experts produced by the parties or appoint their own. In this context, tribunals may appoint their own experts, but it is not necessarily preferable as it may also complicate the proceedings.

Addressing the counsel's perspective, **James Freeman** mentioned the importance of the timing in gas pricing arbitrations. "*These arbitrations are a very delicate exercise; the tribunal has to get it right and cannot rush its decision. But the procedure has to be efficient because otherwise the procedure takes so much time that the next price review is up already*", he advised.

Guillaume Tattevin then asked the panellists what was the fastest gas price arbitration they experienced. **James Freeman** surprised the audience by noting that he had acted as counsel in a gas pricing arbitration that lasted only nine months. The rest of the panel confirmed that some procedures can take as little time as one year.

When questioned on how to effectively argue a gas pricing arbitration, **James Freeman** stressed the importance of the experts because the legal exercise is informed by economics and cannot be understood without it. The lawyer has to be the messenger and has to support the understanding and visualization of the experts' input. It is important to have a story and try not to be too complicated.

Experts in gas pricing disputes perform two functions. First, they provide expertise on the economic aspects of the dispute that relate to the price revision itself, *i.e.* what should the new purchase price be and how is it derived. Second, they can bolster legal arguments by giving credibility to a given interpretation of the price revision clause in light of their knowledge of economics and the markets, testifying whether the legal interpretation furthered by a party makes commercial sense or not, and whether it is consistent with the relevant economic factors.

Valentina Bonetti, the expert on the panel, pointed out that there is rarely a unique truth in economics. Rather, there is a grey zone for interpretation. The role of an expert, whether appointed by a party or the tribunal, is to take a position that is within this grey zone and support it. For experts to take a rigid or extreme position outside this grey zone is, in her view, problematic.

Marion Paris was asked what her recommendations were when the parties submit two diametrically opposed expert opinions. Marion suggested two options. The first one is to decide on a "hybrid" of the two expert opinions, which however comes with the risk of raising jurisdictional issues, because the parties might view such a decision being as *ultra petita*. In this context the enforceability of such an award needs to be considered. The other option for the tribunal is to appoint its own expert. However, this approach is time consuming as it involves several procedural steps: the expert has to be identified and cleared of conflicts; terms of reference must be drawn in consultation with the parties; the expert needs to be provided access to relevant documents, etc. Sometimes the outcome can be unsatisfactory, when the expert report is strongly contested by both parties on all counts.

The panel then turned to the possibility of organizing "baseball arbitrations", where only two alternatives are put forward and the tribunal is not allowed to compromise. In those cases, it is important that both parties put forward a reasonable proposal and that they refrain from gambling.

From the expert's standpoint, **Valentina Bonetti** added that a gas pricing arbitration is always a team effort, the experts providing the numbers and the charts. Experts also provide input and assistance based on their commercial experience and their knowledge of industry standards. For Valentina, an expert's statement that a certain legal assessment "makes economic sense" is usually reassuring both for the party appointing the expert and the tribunal.

Usually experts get involved at the beginning of the arbitration. In Valentina's most recent experience, the experts are sometimes also involved in the negotiation phase, before arbitration is initiated. In her opinion, this is good practice as joint, advance preparation between lawyers, experts and the client has the benefit of avoiding the situation where experts have to defend triggers argued by the parties and their lawyers before their involvement.

Nhu-Hoang Tran Thang, concluded this successful workshop and invited all registrants to a cocktail reception generously sponsored by **LALIVE**.

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