



# Energy disputes

## Revising the price or the price clause?

by  
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# INTRODUCTION

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## Reasons for gas price reviews...

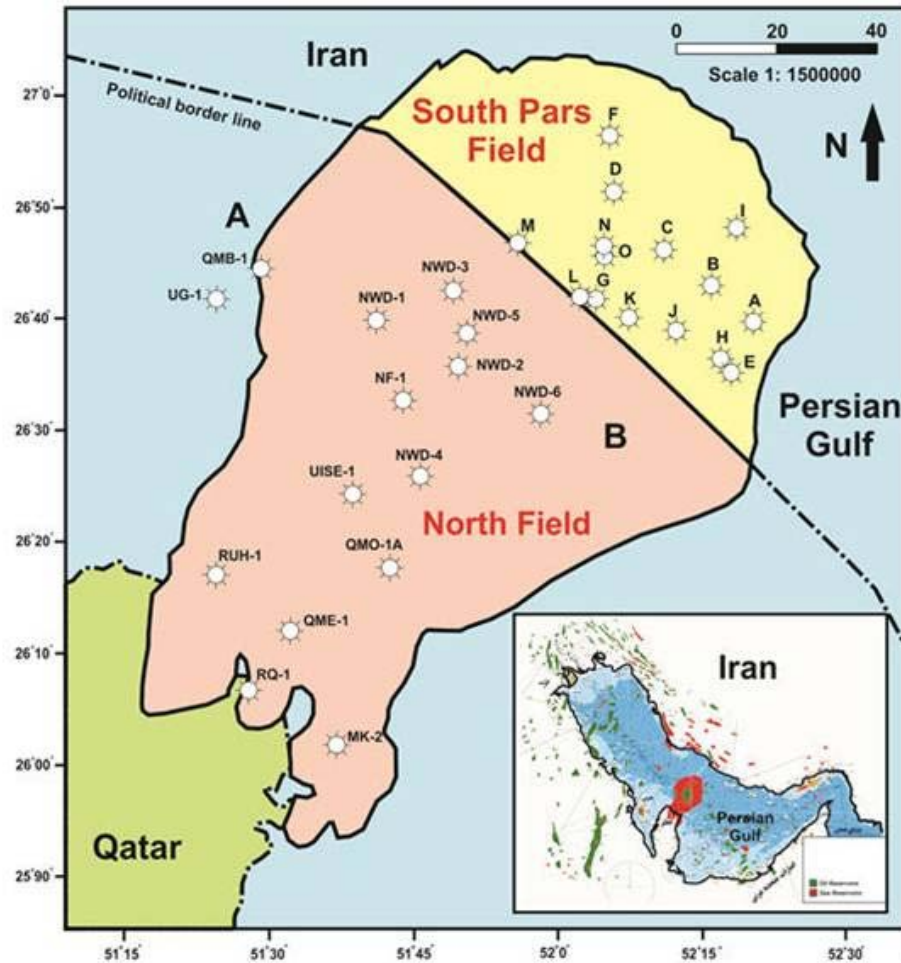
- economic crisis, falling demand and consequential oversupply
- liberalization of gas market in the EU
- availability of large volumes of liquefied natural gas (LNG)
- shale gas revolution in the USA
- emergence of second–or third tier players on the gas market

# Q-MAX TANKER

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# “EDISON’S 450 MIL EURO DISCOUNT ON QATARI LNG HOLDS HOPE FOR EUROPE”<sup>1</sup>



## ANOTHER CASE (1)

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“[T]he award in this case was significant, because it **appears to have effectively re-written the parties’ agreement by fundamentally changing the basis upon which the contract price is determined.** While this may have served justice in this particular case, **such interventionism from tribunals is alarming**”.



## ANOTHER CASE (2)

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- What about *pacta sunt servanda*?
- “Price review arbitration tribunals have to follow the contract – Don’t they”?
- “It is not the job of an arbitral tribunal to re-write the Parties’ contract for them”.

# THE ARBITRATOR'S TASK DEPENDS ON...

- the governing law
- the words of the price review provision
- the existing price formula
- the arbitration clause
- the relationship between the price review clause, the price formula and the rest of the agreement

# THE GOVERNING LAW

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Important mainly for two reasons:

- **Remedy:** the governing law may or may not provide for the kind of remedy a claimant wishes to seek
- **Rules of Interpretation:** may differ and yield different results



# CONTRACT INTERPRETATION-ENGLISH LAW

## *Investors Compensation Scheme v West Bromwich Building Society (1997)*

1. Interpretation = to ascertain meaning a document would convey to a **reasonable person** with all background knowledge reasonably available to parties **at time of contract**.
2. “Background” or “matrix of fact” includes anything that would have been reasonably available to the parties and would have affected the way in which the language of a document would have been understood by a reasonable man.

# CONTRACT INTERPRETATION-ENGLISH LAW

## *Investors Compensation Scheme v West Bromwich Building Society cont'd*

3. Admissible background **does not comprise previous negotiations** and declarations of subjective content.
4. Meaning of a document to a reasonable man is not the same as the meaning of its words.
5. Meaning of words = “natural and ordinary meaning”.

# CONTRACT INTERPRETATION - CISG

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## Article 8

1. Statement interpreted according to a party's intent where the other party could not have been unaware of that intent.
2. If (1) not applicable, interpretation according to the understanding a **reasonable person** of the same kind as the other party would have had in the same circumstance.
3. To determine intent or the understanding of a reasonable person: all relevant circumstances, **negotiations**, established practices, usages, **subsequent conduct**.

# PRICE REVIEW CLAUSE I

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- **NO TRIGGER EVENT**

“The parties agree to meet regularly to proceed with the revision of the Contractual Sales Price [...] they shall so meet for the first time during the first quarter of the year 1980 and thereafter every **four (4) years**”.

- **NEGOTIATION GUIDELINES**

Revision of price by “adapting it in a **reasonable and fair manner** to the **economic circumstances** then prevailing on the **important Natural Gas market** and on the market for the other imported energy supplies competing with this production in the **East Coast and Golf Coast areas of the United States of America** within the framework of long term contracts[...] ”

Taken from: Sonatrach (Algeria) & Distrigas Corporation (USA) LNG SPA 1976

# PRICE REVIEW CLAUSE II

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- **TRIGGER EVENT**

**“If economic circumstances in Spain beyond the control of the Parties, while exercising due diligence, have substantially changed as compared to what [the Party] reasonably expected when entering into this Contract [...].”**

- **NEGOTIATION GUIDELINES**

**“In reviewing the contract price [...] the Parties shall take into account levels and trends in price of supplies of LNG and Natural Gas [redacted] such supplies being sold under commercial contracts currently in force on arms length terms, and having the regard to all characteristics of such supplies [...].”**

Taken from: Atlantic LNG Company of Trinidad and Tobago and Gas Natural (Spain) LNG SPA 1995

# PRICE REVIEW CLAUSE III

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- **TRIGGER EVENT**

“If circumstance beyond the control of either Party results in a **significant change in the energy market of the Buyer**”.

- **NEGOTIATION GUIDELINES**

“**If the Parties fail to agree a revised price formula** within 90 days after giving notice for a price review, **the price formula shall be reviewed by arbitration**. In any such arbitration the arbitrators shall review the price formula and shall **decide whether it needs to be revised** to reflect, as at the review date, the **relevant significant change(s) in the energy market of the Buyer**.”

# PRICE FORMULA

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## 2 Main Elements:

1. Base Price ( $P_o$ )
2. Price Escalation Supplement
  - Substitute Fuel(s)
  - Pass Through Factor(s)
  - Energy Conversion Coefficient(s)



# PRICE FORMULA

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The Contract Price  $P_n = [\text{Contract Currency}] / \text{kWh}$  and calculated as follows:

$P_n$  [Contract Price] =  $P_o$  [Base Price] + 0.1 [Weight of Substitute Fuel] \* 0.23 [Pass Through Factor] \* 0.00456 [Energy Conversion Coefficient] \*  $(S-S_o)$  [Substitute Fuel-Straw]

+  $0.7*0.80*0.009123*(Pe-Pe_o)$  [Substitute Fuel-Pellets]

+  $0.4*1.00*0.05678*(SD-SD_o)$  [Substitute Fuel-Saw Dust]

# WHAT CAN BE CHANGED, PERHAPS....







## I. Change of Base Price ( $P_o$ )

- temporary circumstances
- permanent circumstances

## II. Price Escalation Supplement

- maybe possible: change relative weight of substitute fuels and/or introduce new substitute fuel
- impossible to change: Energy Conversion Factor(s)  
Pass Trough Factor(s)

# CHANGE OF PRICE ESCALATION SUPPLEMENT

Old Formula		New (weight of substitute fuel changed)		New (weight change & new substitute fuel)	
<b>STRAW</b>	30%		40%		35%
<b>PELLETS</b>	40%		45%		20%
<b>SAW DUST</b>	30%		15%		<b>COW DUNG</b> 45%
<b>100%</b>		<b>100 %</b>		<b>100%</b>	

# **TO BE CONSIDERED...**

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- geographical market(s)
- product market(s)
- market level(s)
- market segment(s)
- price structure and developments
- economics
- mathematics

# ABOUT QUANTITIES AND NUMBERS

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Example: **10 billion m<sup>3</sup> natural gas/annum.**

**P<sub>o</sub> = 1, 5 EUR cents/kWh.**

1m<sup>3</sup> natural gas:  $\approx 31.735$  kWh

10 bn m<sup>3</sup> natural gas:  **$\approx 317.350$  bn kWh**  
(317, 350 TWh)

$\approx 317$  bn kWh @ EUR cents **1,500/kWh** :  $\approx$  **EUR 4,8 bn**  
@ EUR cents **1,625/kWh** :  $\approx$  **EUR 5.2 bn**

$\Sigma$  : **+/- 0,125 EUR cent/kWh change** :  $\approx$  **EUR 400 mn**

Over- or underpayment within review period e.g.3 years: **EUR 1,2 bn**

# THANK YOU!

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