Gas Sale and Purchase Agreements ("GSPAs") are typically long term contracts—some extending for the life time of the gas field/reservoir. Despite the advent of spot markets for gas and the increasing ability to trade natural gas as Liquefied Natural Gas ("LNG") over long distances, market participants still consider the long term GSPAs as an important element in their commercial transaction and the reason is not far-fetched: there are significant cost implications for the development of a gas project before financing the project. The exploration of reserves, construction of pipelines, gas processing plants, liquefaction facilities and the purchase of LNG tankers are all multi-billion dollar investments which are typically borne by a financier ‒ usually a Bank or consortium of Banks ‒ who want assurance or certainty of Returns on Investments ("RoI").

The length of the contract term of GSPAs also poses another challenge: contracting parties ‒ gas marketers, distributors and utility companies ‒ must take into consideration the unpredictability of the market when agreeing on the “appropriate” price for gas. Some context is required here. It is impracticable for the parties, at the time of entering the contract, to fully determine the price of gas for the duration of the contract as the price of gas is usually determined by variables [fully discussed here] which are not totally within the parties control at the time the contract is signed.

Therefore, when entering into long-term gas supply contracts, gas marketers, distributors, and utilities must account for the unpredictability of the market when agreeing on the gas price. This unpredictability has been accentuated by recent trends in the market, including most notably a drop in the demand for gas in Continental Europe, an increased LNG supply world-wide, a decrease in LNG demand in North America as a result of unconventional gas production, and the economic recession, amongst others. As a result of these forces, the price of gas on the spot or resale market has plummeted, while the oil-indexed price of gas, which many long-term gas supply contracts use as a pricing formula for gas, is on the rise. To address ‒ perhaps, mitigate ‒ these challenges, most, if not all, long-term gas supply contracts contain a price review clause, permitting the parties to adapt the base price and gas pricing formula in their contract through negotiation or, if necessary, by recourse to arbitration.

The term price review (or re-opener) is a term used to refer to a variety of different clauses that allow the existing price formula to be adapted or replaced in specified circumstances. There is no generic phrasing for price review clauses but a sample clause would typically read somewhat like this:

(a) If at any time either Party considers that economic circumstances in Spain beyond the control of the Parties, while exercising due diligence, have substantially changed as compared to what it reasonably expected when entering into this Contract or, after the first Contract Price revision under this Article 8.5, at the time of the latest Contract Price revision under this Article 8.5, and the Contract Price resulting from application of the formula set forth in Article 8.1 does not reflect the value of Natural Gas in the Buyer’s end user market, then such Party may, by notifying the other Party in writing and giving with such notice information supporting its belief, request that the Parties should forthwith enter into negotiations to determine whether or not such changed circumstances exist and justify a revision of the Contract Price provisions and, if so, to seek agreement on a fair and equitable revision of the above-mentioned Contract Price provisions in accordance with the remaining provisions of this Article 8.5.

(b) In reviewing the Contract Price in accordance with a request pursuant to sub-Article 8.5(a) above 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...
We can see from the above stated sample that price review clauses typically contain the following features: (a) A trigger event or situation (b) A procedure for arriving at the adjusted price (c) A description of the factors or guidelines to be taken into account when adjusting the price (d) The consequences if an agreement on price is not reached, and (e) A description as to how the adjusted price is to apply under the contract. Often times –and for varying legitimate reasons – parties to a long term GSPA may not come to mutually agreeable position during the price review and would have to resort to the dispute resolution provisions of the contract to resolve these differences. Considering that the GSPAs are very high value contracts and the commercial exigencies of same would not allow for long drawn out litigation to resolve differences, it is not uncommon to find that GSPAs incorporate elaborate dispute resolution procedures which cascade through expert determination and then arbitration –most often as a last resort. We shall analyze each of these procedures below.

Expert Determination

According to Justice McPherson¹, an expert determination is an “inquiry that presents a question to be answered on the basis of individual experience, expert knowledge, and personal inquiry and investigation”. It has been defined –though used in the context of the intellectual property dispute, it still holds true for dispute arising out of GSPA—as “a procedure in which a dispute or a difference between the parties is submitted, by agreement of the parties, to one [or more] experts who make a determination on the matter referred to it [them].”² The determination is binding, unless the parties have agreed otherwise.

Expert determination is, by its nature, flexible, highly effective and less adversarial. It is however important to note under the terms of the contract, and accordingly the effect of an expert determination clause is entirely dependent on the contractual provisions. Often times, expert determination clauses in long term contracts do not contain detailed provisions of the scope and extent of the powers of the expert. This would typically be drawn up in a separate document referred to as “Terms of Engagement”.

The most important aspect of expert determination is that although it may appear straightforward, it can in practice give rise to serious dispute if the terms are not clear and comprehensive. It would thus be advisable that parties, in drafting the expert determination clause, take adequate care to ensure that their intentions are expressed lucidly and without ambiguity. Additionally –and in contradistinction to arbitration – there is no statutory regime governing expert determination, and therefore no prospect of appeal on a point of law. It is therefore imperative that the parties explicitly state whether the expert is being asked to express a view as an expert or render an award as an arbitrator.

Arbitration

It is noteworthy that, because of its weak enforcement mechanisms, parties to a long term GSPA rarely resort to expert determination in resolving price review issues. The more prevalent approach is to refer the matter to arbitration. While mediation/negotiations will be the preferred method to respond to minor changes in the market, when market fluctuations are volatile enough one (or both) parties may be incentivized to push instead for arbitration.

Arbitration on price review clauses are often long drawn-out and contentious. This is due largely to the fact that determining the price formulae in a long term GSPA is a complex art. Several factors are taken into consideration by the buyer and the seller –often times with conflicting positions. It is thus a “battle”—literally—for the parties to agree to a pricing scheme that adequately addresses the concerns of both parties. In drafting the arbitration clause, some of the practical issues that parties are advised to direct their minds to are:

a. persons with the right qualifications –this is used loosely to imply persons with adequate knowledge of the long term gas supply market –are chosen as arbitrators. The parties would have to determine if they would prefer a sole arbitrator or a 3 person arbitration panel. There are obviously advantages and disadvantages to any of the choices. The most obvious being that a sole arbitrator would mean significantly lower cost of arbitration and a 3 person panel means that neither party has full control of the appointment process.

b. the powers of the arbitrators are spelt out clearly and limited, if the parties desire. The danger with having arbitrators with vague powers is that they may well enter an Award that exceeds the parties' wishes. This can be achieved by the parties inserting the “baseball arbitration” clause. Under the baseball arbitration clause, each party submits a proposed monetary award to the tribunal. After the final hearing, the tribunal chooses one award from those submitted, without modification. Given the financial outcome of price revisions, which are often very significant, a three-member tribunal is more appropriate to balance the parties' expectations.

¹ Arbitration, Valuation and Certainty of Terms’ (1986) 60 Australian Law Journal 8 at 16

“No Victor, no Vanquished”
– Yakubu Gowon
It is not unusual to have multiple arbitration clauses in a long term GSPA. Parties may agree to a separate arbitration clause for price review —where 3 persons are appointed and given explicit powers—and another arbitration clause for other specific disputes —where a sole arbitrator is appointed. Where the parties resort to multiple arbitration clauses due care should be taken to ensure that there are no ambiguities that may cause jurisdictional nightmare for the parties.

**Conclusion**

By their nature, long term GSPAs are complex and can be ambiguous in some instance—there can be ambiguity as to whether a price review mechanism is triggered. Often, such mechanisms are drafted in general terms in order to provide flexibility between the parties. There are arrays of options available when negotiating price review provisions and the drafting choices made by the parties can have an impact on the magnitude and complexity of future pricing disputes. Proper consideration of price review provisions is key and can help limit the uncertainty in price review arbitrations.

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For further information, kindly contact Nnamdi Ukamba at the above mentioned contact details or alternatively send an email to info@advocaat-law.com