

# International Arbitration in the Energy Sector: COMMERCIAL ARBITRATION



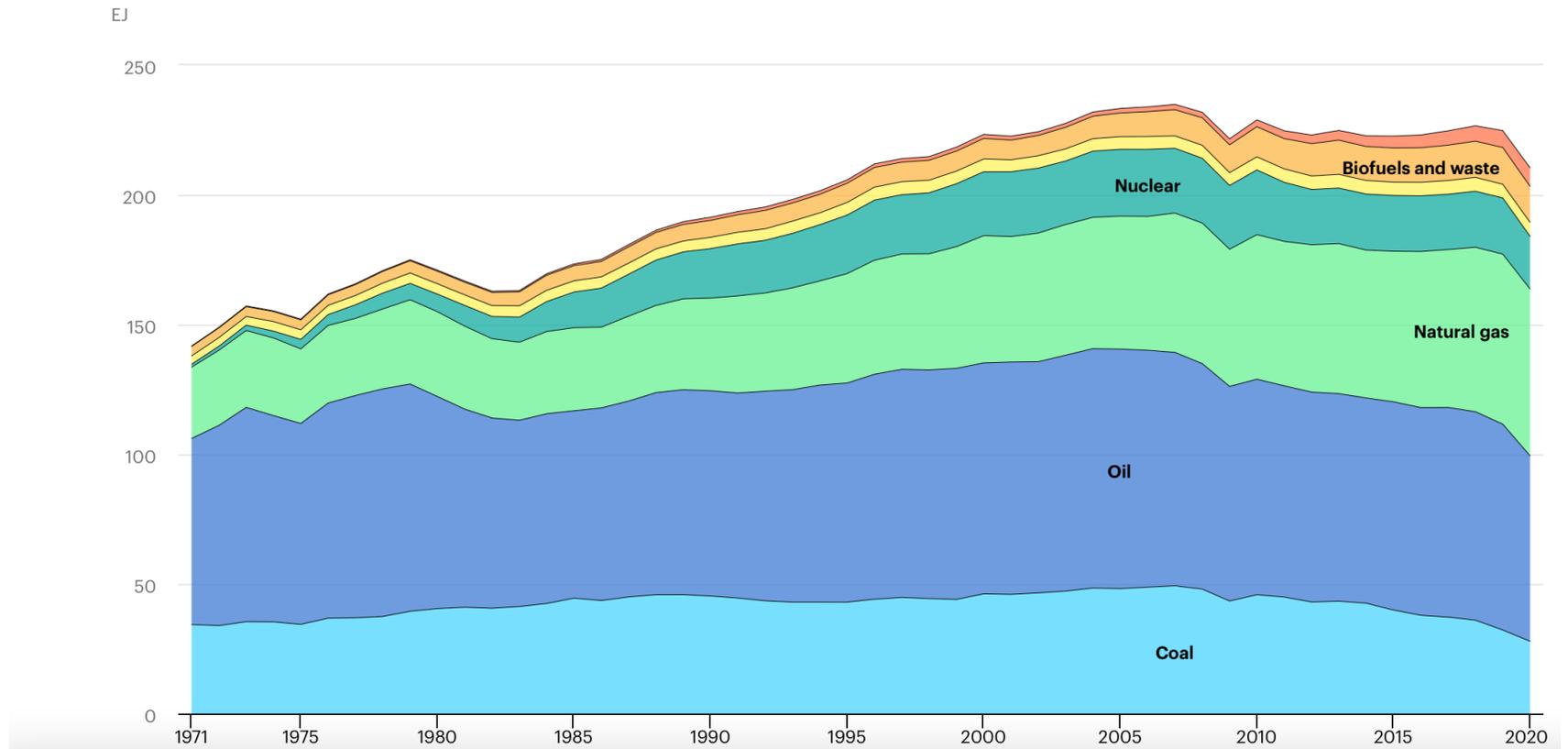
**MUNI  
LAW**

# **Energy Sector**



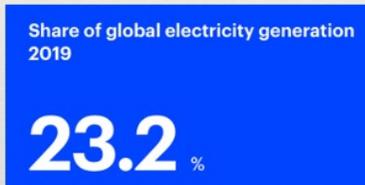
# Fuels

OECD total energy supply by source, 1971-2020



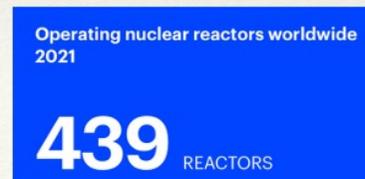
## Renewables

*Renewables, including solar, wind, hydro, biofuels and others, are at the centre of the transition to a less carbon-intensive and more sustainable energy system.*



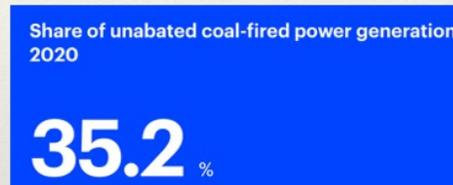
## Nuclear

*Nuclear power has historically been one of the largest global contributors of carbon-free electricity, however, it faces significant challenges in some countries.*



## Coal

*Coal is both the largest source of electricity generation and the largest single source of CO2 emissions*



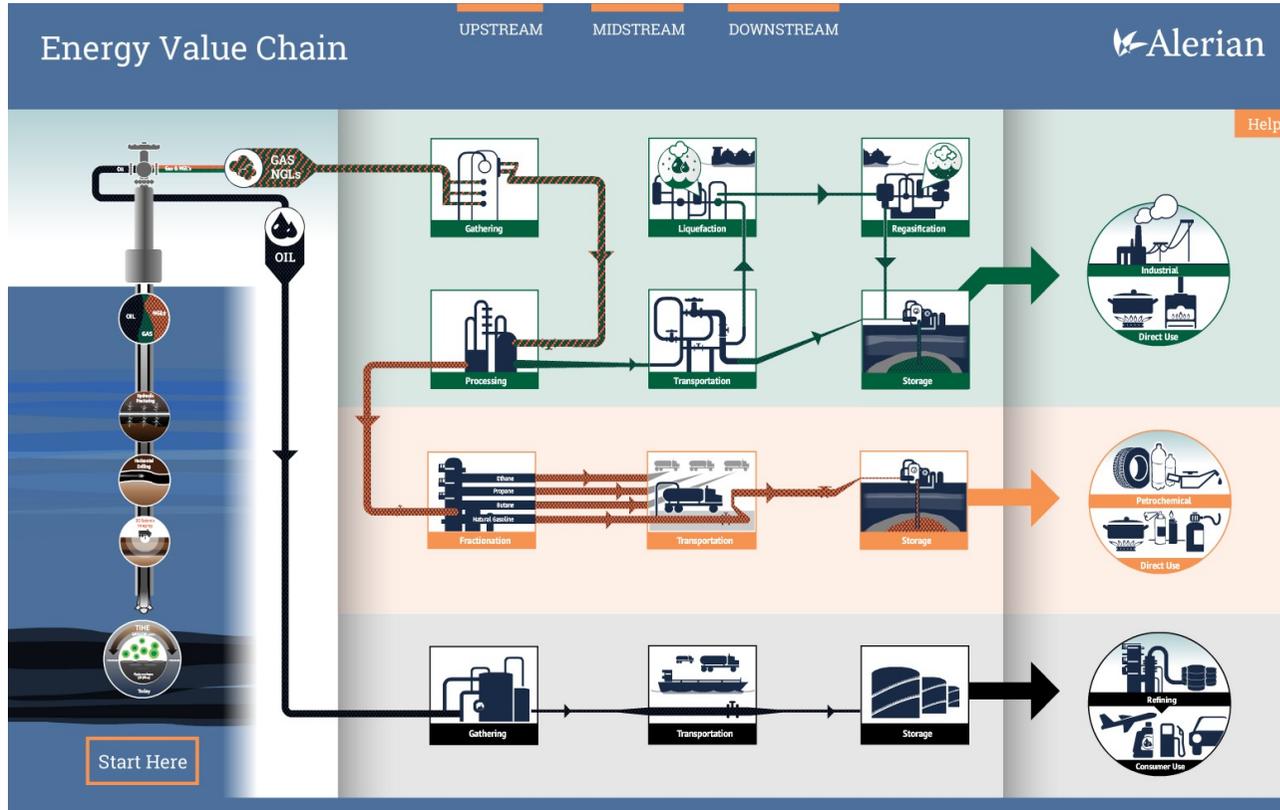
## Oil

*Coal is both the largest source of electricity generation and the largest single source of CO2 emissions*

## Gas

*Natural gas is the cleanest burning and fastest growing fossil fuel, now accounting for about a quarter of global electricity generation*

# Energy Value Chain: Oil & Gas



# Energy Value Chain: Oil & Gas

## Upstream

### Exploration and Production

Searching for potential underground or underwater crude oil and natural gas fields, drilling exploratory wells, and subsequently drilling and operating the wells that recover and bring the crude oil or raw natural gas to the surface.

**PIONEER**  
NATURAL RESOURCES

**ConocoPhillips**

## Midstream

### Transportation Storage

Companies operating tanker ships, pipelines or storage facility.

**KINDER MORGAN** **ENBRIDGE**

### Oil Service Companies

Provide products and/or services to the oil and gas industry. Usually a combination of labor, equipment, and/or other support services.

Baker Hughes 

**HALLIBURTON**

  
SAIPEM

## Downstream

### Refining Consumer use

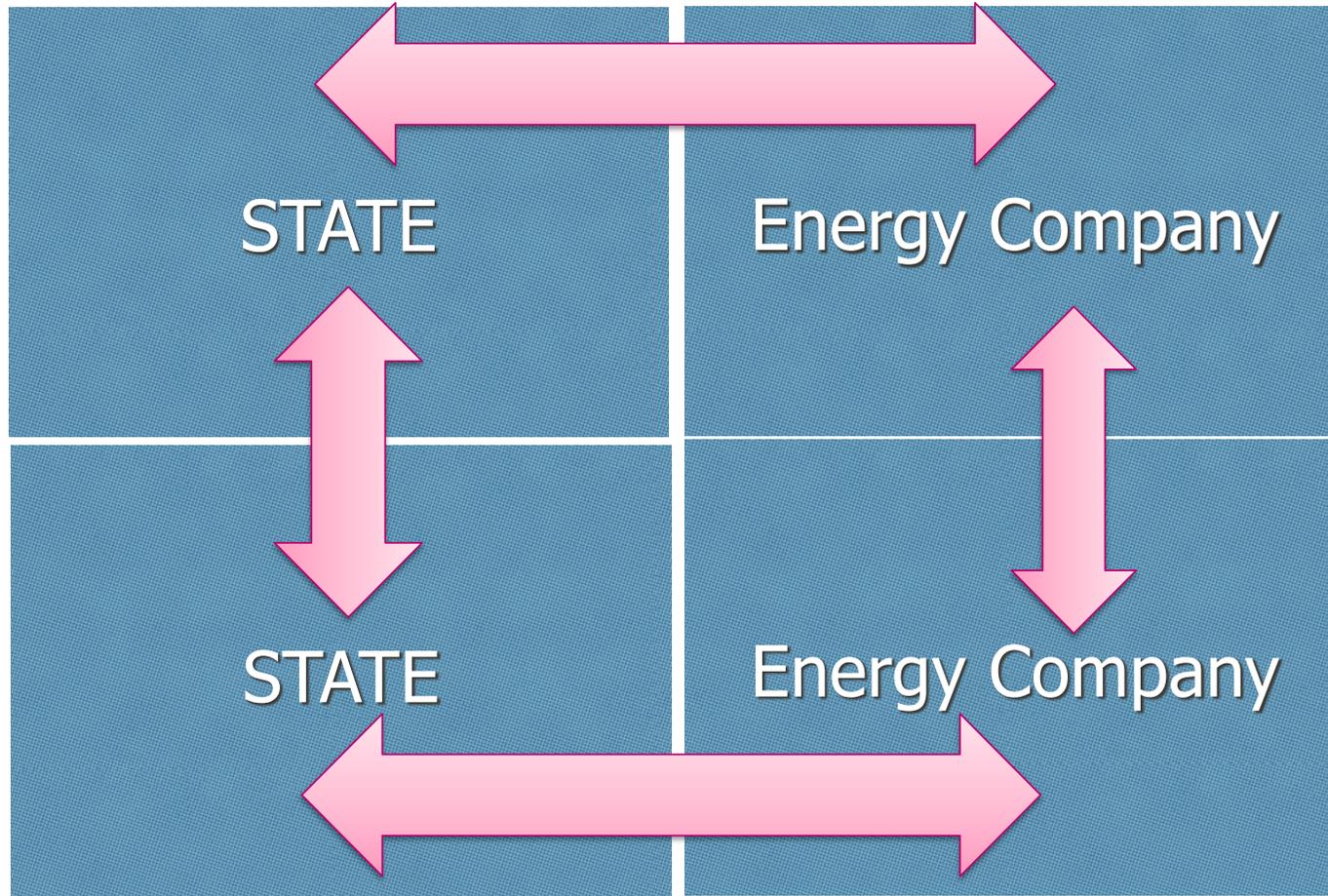
  
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## Integrated Companies



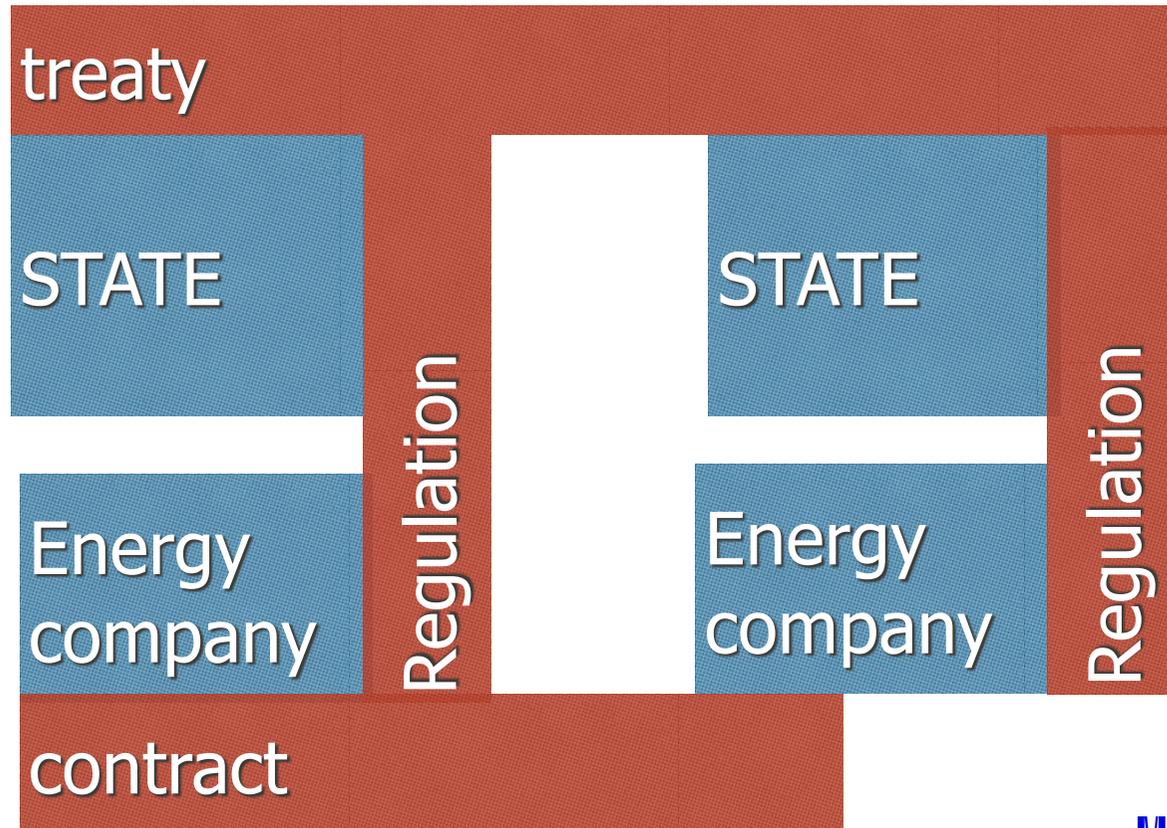
## Stakeholders and legal relationships



## Stakeholders and legal relationships

**INTERNATIONAL LAW**  
dimension

**NATIONAL LAW**  
dimension



## Stakeholders and legal relationships

**INTERNATIONAL LAW**  
dimension

Germany v. Russia



**NATIONAL LAW**  
dimension



RWE v. Gazprom

# UPSTREAM

## ENERGY SOURCE



## VISUALIZATION



### Total Petroleum and Other Liquids Production - 2017 >

Thousand Barrels Per Day

1. United States
2. Saudi Arabia
3. Russia
4. Canada
5. China
6. Iran
7. Iraq
8. United Arab Emirates
9. Brazil
10. Kuwait
11. Mexico
12. Venezuela
13. Nigeria
14. Norway
15. Qatar



# Exploration & Production

Permanent sovereignty over natural resources

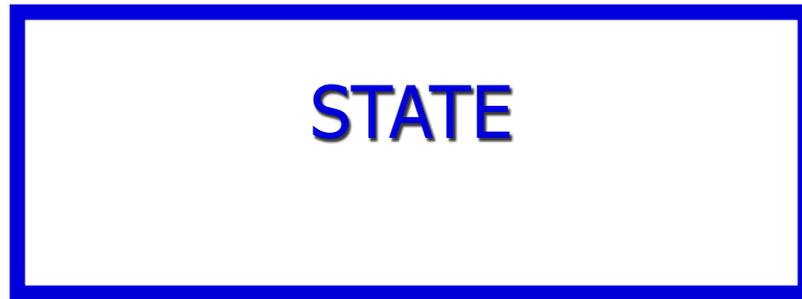
In many countries, underground natural resources, such as oil, gas or groundwater, belong to the state.

The content of ownership and the restrictions within which the individual can exercise the right of ownership is defined by each sovereign state.

Whether natural resources may be the object of a private property rights is determined by the body of domestic administrative law setting forth conditions under which natural resources may be explored and exploited (agreements, licenses, concessions, environmental regulation) as well as conditions under which the property rights are transferred to non-state actors (taxes, royalties).

# Unequal distribution of natural resources

## UPSTREAM: Legal Disputes

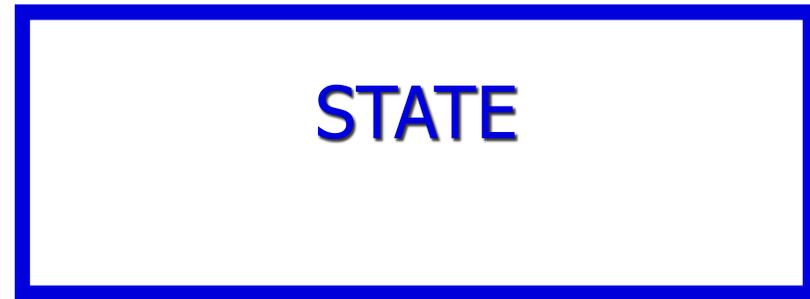
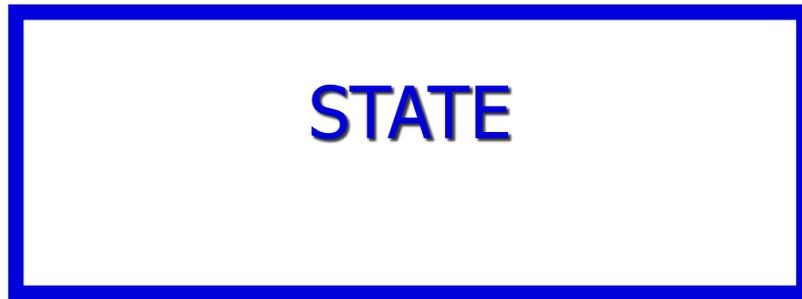


Permanent sovereignty over natural wealth and resources:

- 1) **States set forth conditions under which natural resources are to be utilized.**
- 2) States pursue public interest such as the protection of environment, economic development.

## **Disputes between states and energy companies**

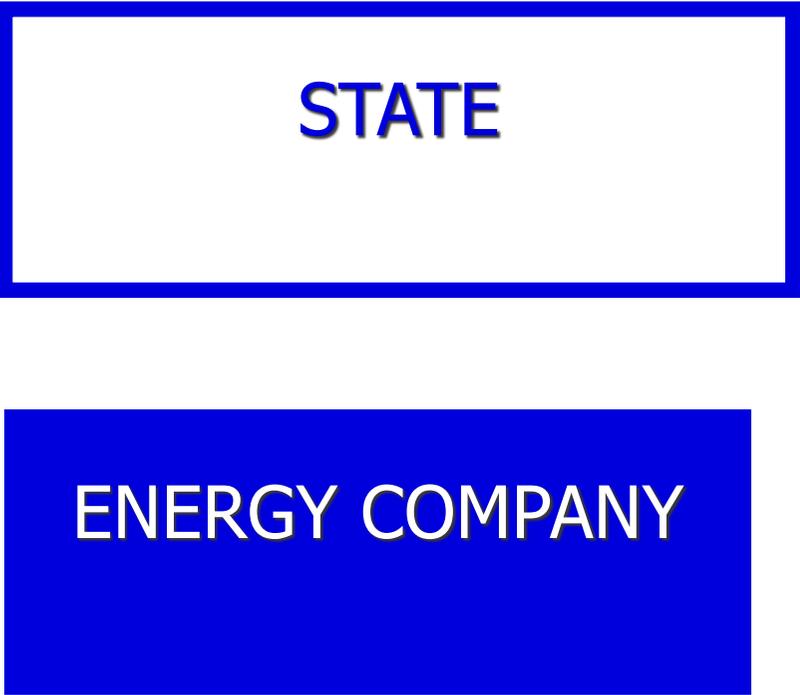
## UPSTREAM: International Boundary Disputes



Permanent sovereignty over natural wealth and resources applies only in relation to a state territory (state jurisdiction).

However, boundaries, particularly maritime boundaries, are often challenged > **disputes between states.**

## MIDSTREAM AND DOWNSTREAM



STATE

ENERGY COMPANY

States set forth conditions under which energy is to be transported and traded. States pursue public interests.

TRANSIT STATES (regulation)  
ENERGY MARKETS (regulation)

Transportation of oil / gas.

Sales from the producer to the wholesaler in a particular market, sales from wholesalers to the end users.

International dimension:

Cross-border transportation of oil/gas (pipelines / tankers)

Cross-border trade in energy products.

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# AGENDA

- A) State – State Arbitration**
- B) Commercial Arbitration**
- C) Investor – State Arbitration**

# International Arbitration

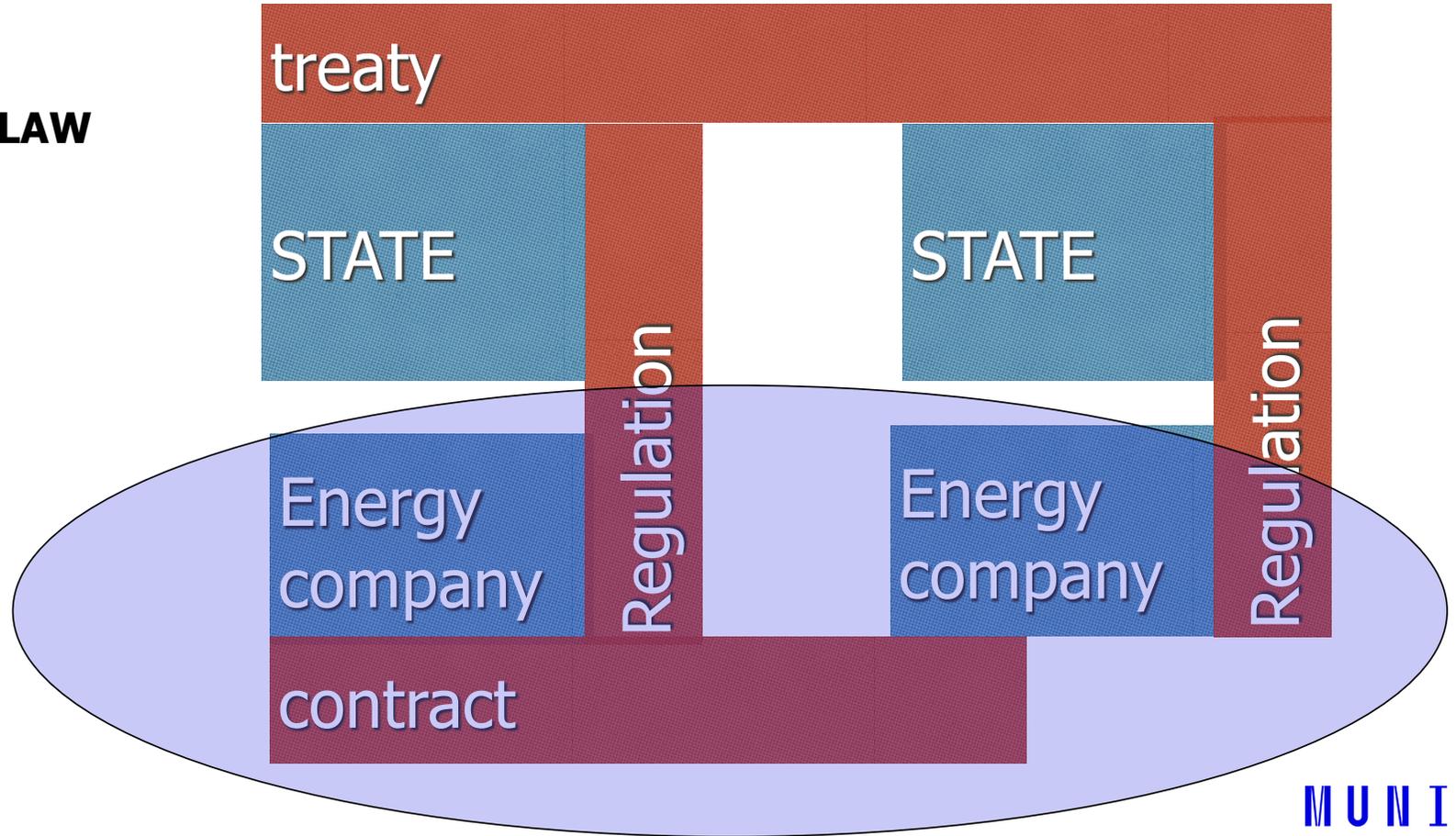
- A) State – State Arbitration
- B) Commercial Arbitration**
- C) Investor – State Arbitration

# COMMERCIAL ARBITRATION

# Commercial Arbitration

**INTERNATIONAL LAW**  
dimension

**NATIONAL LAW**  
dimension

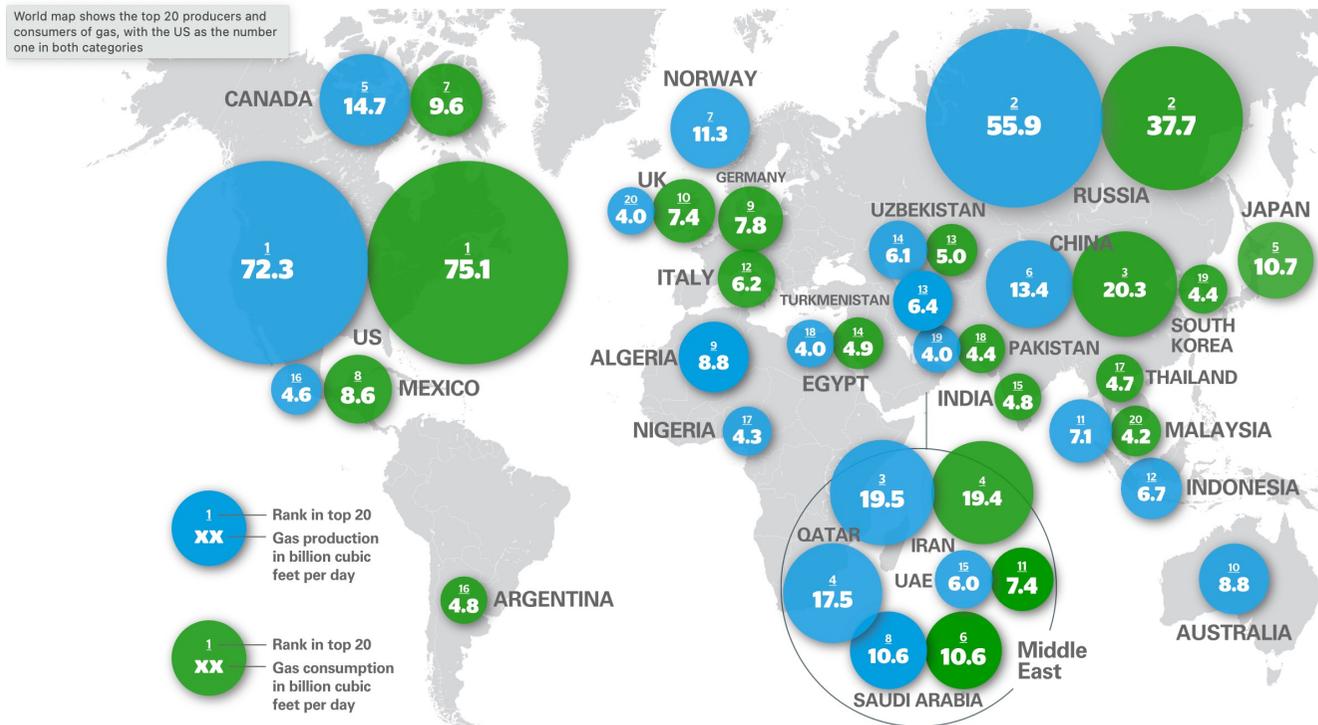


## CASE Study: Natural Gas

**Natural gas** is found in nature in its fossil state on its own or together with oil and other hydrocarbons. Natural gas is used to produce **electricity, heating** and serves as a **feedstock** for chemicals. Getting extracted natural gas to the place where it is consumed is a very challenging process.

## CASE Study: Natural Gas

**Natural gas** is found in nature in its fossil state on its own or together with oil and other hydrocarbons. Natural gas is used to produce **electricity, heating** and serves as a **feedstock** for chemicals. Getting extracted natural gas to the place where it is consumed is a very challenging process.



## STAGE I: Production and processing contracts

Permanent sovereignty over natural wealth and resources:  
**States set forth conditions under which natural resources are to be utilized. Disputes between states and energy companies**



### Drilling Contract

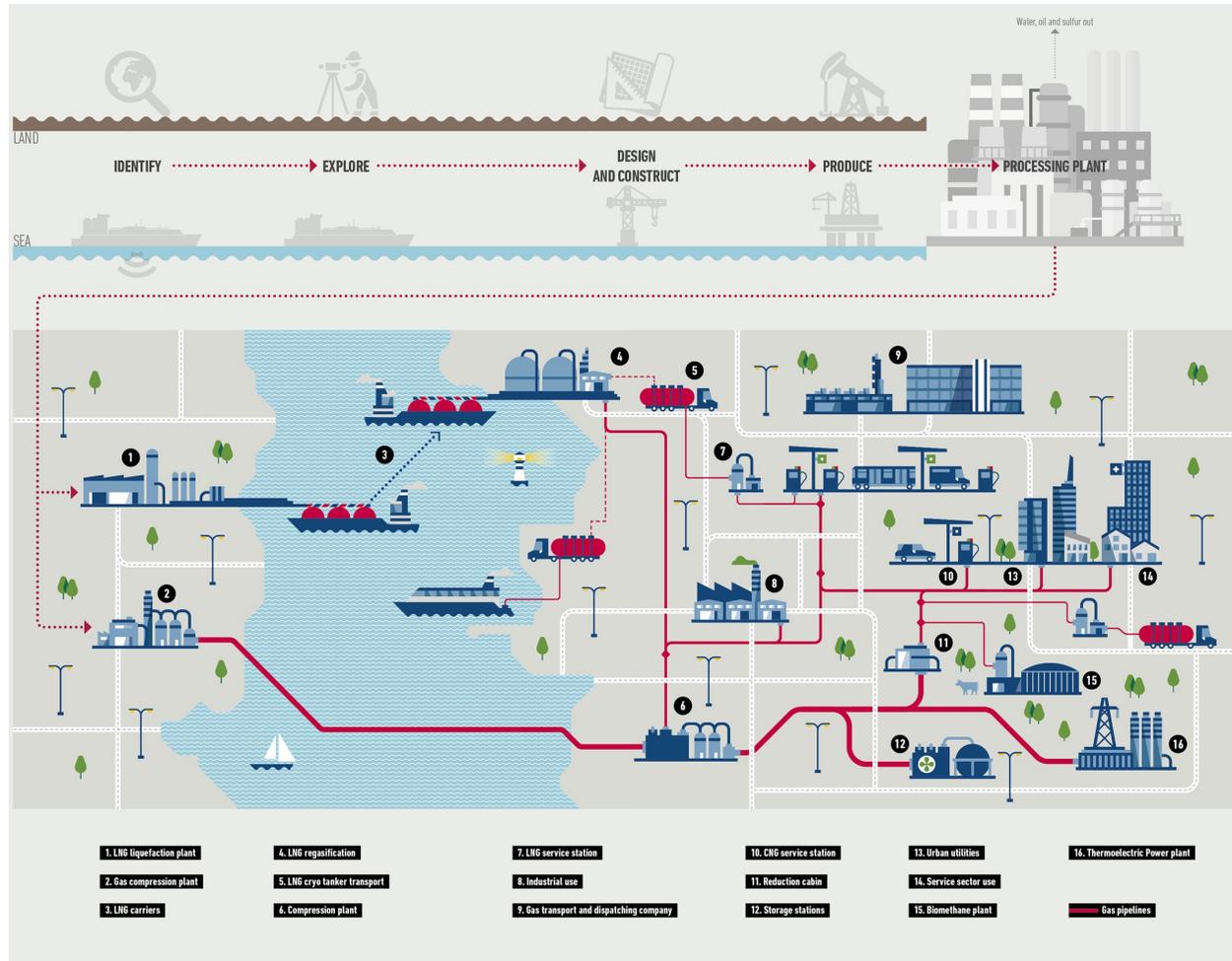
It is a common practice for the producer to enter into **a contract with an oilfield service contractor to drill wells**. Contractor is paid a day rate based on the number of days necessary until the well is drilled to a target depth, or a certain amount for every feet that is drilled, or a lump sum to drill the well.



### Gas processing agreement

Once the gas has been extracted, the next step is to **process it**. Raw gas consists of a variety of hydrocarbons and contains impurities (such as sulphur). Processing facility for the gas is, thus, needed and producers enter **into gas processing agreements**.

# MIDSTREAM AND DOWNSTREAM



## STAGE II: Sales from producers to wholesalers (midstream)

There are 2 primary ways to transport natural gas over long distances to end markets.

- A) **Pipelines**
- B) **LNG** (involves cooling of the gas in a liquification facility to -161 degrees Celsius)

### **Pipeline:**

Is there a pipeline?

Should it be built by the producer / joint venture between buyer and seller / third party?

**A contractual relationship between the shipper and the owner or operator of the pipeline.**

## STAGE II: Sales from producers to wholesalers (midstream)

- Supplying gas by a pipeline is extremely capital intensive.
- Thus, **producers need guaranteed purchases** of sufficient quantities of gas over a long period of time.
- **Wholesalers** aim to secure supply over an extended period of time since they have usually significant downstream supply obligations.

### **LONG TERM GAS CONTRACTS** (Gas Sales and Purchase Agreements)

- Terms between 10 and 30 years.

*An alternative:*

### **GAS HUBS**

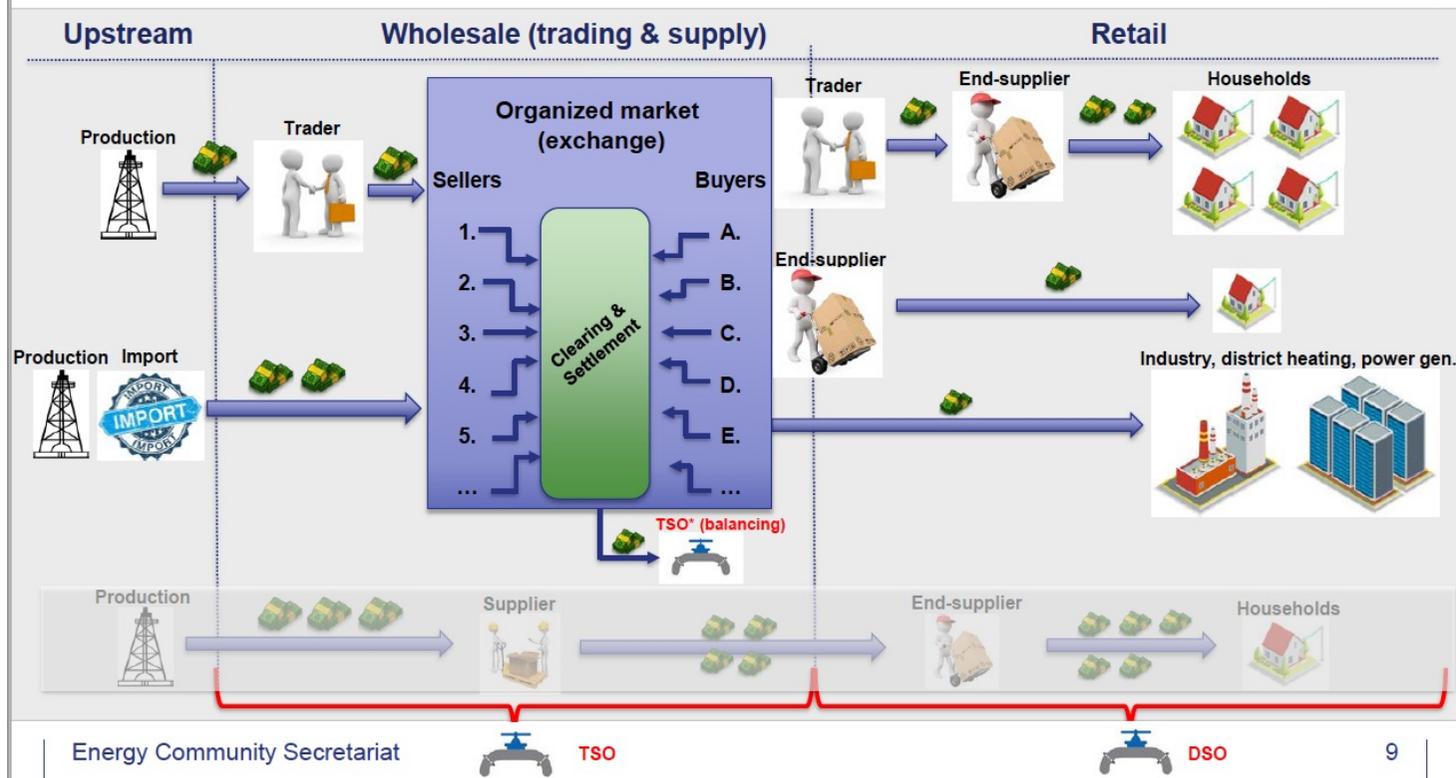
- **Gas hub is used as a central pricing point for the network's natural gas.**
- A gas exchange allows a shipper or trader to buy or sell gas. The gas exchange operator is responsible for bringing together the volumes of gas offered and the volumes of gas requested and facilitates the financial transaction.
- **In recent years increasing volumes of gas are being purchased on gas hubs.**
- **Gas may be purchased on a spot or forward basis.**

*(liberalization of gas market + infrastructure)*

# An organized market



An "organized" market



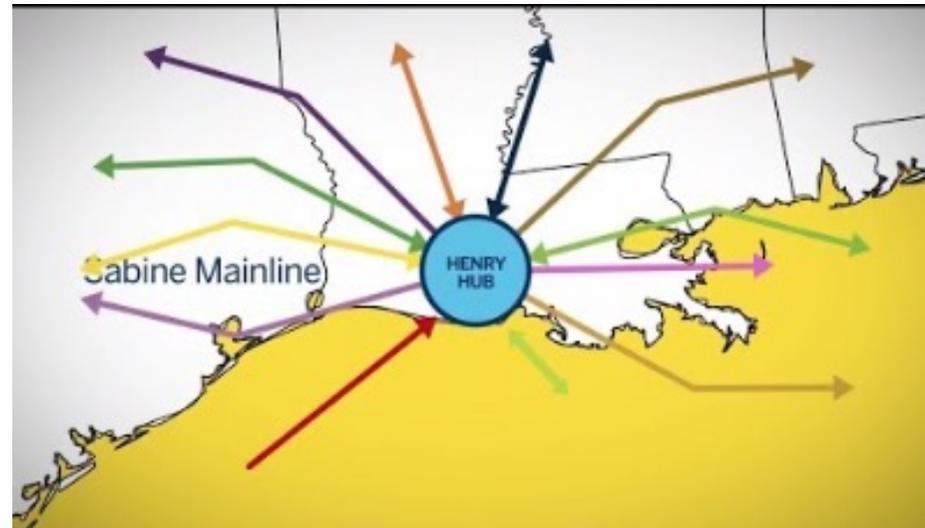
## PHYSICAL /VIRTUAL GAS TRADING HUB

A physical hub is a geographical (centrally located and sufficiently interconnected) point in the network where a price is set for natural gas delivered at that specific location. This mostly exists in North America with the Henry Hub as a typical example. The EIA defines the presence of multiple converging and interconnecting pipelines, as well as numerous trading parties, as the foundation for such a hub.

**Henry Hub is the third largest physical commodity futures contract in the world by volume**

### Dutch TTF

has become by far the largest single traded gas hub in Europe



# Gas Sale and Purchase Agreements

## Delivery point

- Title to the gas passes from the Seller to the Buyer at the delivery point (the delivery point is often located at the border to the country in which the wholesaler has the market).

## Quality of the gas to be delivered

- Pressure, temperature, composition

## Supply volumes

- Volumes of gas the Buyer must purchase, and Seller must supply (most often in form of the annual obligation).

## Take or pay obligation

- The Buyer is obliged to pay for the designated volume of gas each year even if the Buyer does not take it (this is the KEY PROVISIONS ENSURING FINANCING FOR THE INFRASTRUCTURE NEEDED TO PRODUCE AND DELIVER GAS).
- To ensure that the producer would be able to **repay the money borrowed for the purposes of bringing the gas to commercial production, the sources of financing required the producers to obtain a guaranteed, long-term revenue stream from downstream buyers.** (long-term cashflow)

## Supply flexibility

- Flat – same volume at all times
- Flexible – offtake of volume may vary. The buyer's obligation to take the gas is flexible (annual flexibility, seasonal flexibility, daily flexibility)

# Gas Sale and Purchase Agreements

## Price

- The Buyers are willing to undertake the volume commitment, but **they need to be assured that the price paid to the Seller would remain viable in the long term- even as changed market conditions affect the price.** (if the price that the buyer is paying upstream to the supplier is more than the price that the buyer can receive downstream from the end users – there is no margin and would go quickly out of business). **The balance is achieved when the contract price is defined by reference to the price that end users pay for gas in the market - a formula self-adjusting the price over time.**
- **Price of oil and oil products is expressed by international benchmark prices** (indexing), however, **there are not universally applied gas benchmarks.**
- GSPA do not use fixed prices, since neither B nor S is willing to take a risk of an unchanging price for a contract of 10-30 years duration. Gas price is usually composed of **a fixed base component** and a **reference to indexed prices of other products** (most often of oil products).

## Price review

- This clause is typical for long term contracts and should be read in conjunction with the take or pay obligation clause.

## Force majeure

- Buyer may be excused from its obligation to pay for, or Seller may be excused from its obligation to supply the gas.
- Usually, force majeure is intended to cover a narrow range of circumstances that are outside of the control of the party asserting force majeure and whose effect is to render it impossible for one party or the other to fulfil its contract.

SPECIFIC TERMS IN THIS EXHIBIT HAVE BEEN REDACTED BECAUSE CONFIDENTIAL TREATMENT FOR THOSE TERMS HAS BEEN REQUESTED. THE REDACTED MATERIAL HAS BEEN SEPARATELY FILED WITH THE SECURITIES AND EXCHANGE COMMISSION, AND THE REDACTED TERMS HAVE BEEN MARKED AT THE APPROPRIATE PLACE WITH TWO ASTERISKS (\*\*)

NOBLE ENERGY MEDITERRANEAN LTD.  
DELEK DRILLING LIMITED PARTNERSHIP  
ISRAMCO NEGEV 2 LIMITED PARTNERSHIP  
AVNER OIL EXPLORATION LIMITED PARTNERSHIP  
DOR GAS EXPLORATION LIMITED PARTNERSHIP  
and  
THE ISRAEL ELECTRIC CORPORATION LIMITED  
GAS SALE AND  
PURCHASE AGREEMENT  
DATED March 14, 2012

מסמך זה נמצא באתר האינטרנט של מוני לוקס

19.4 **Arbitration**

- 19.4.1 Except as referred to an Expert as set forth in Articles 19.2 and 19.3, any Dispute shall be referred to and finally and exclusively resolved by arbitration in accordance with this Article 19.4.
- 19.4.2 Disputes relating to matters with an amount in controversy of less than (\*\*) shall be determined by a single arbitrator, in accordance with the Rules of Arbitration of the Israeli Institute of Commercial Arbitration. The seat of the arbitration shall be (\*\*). If the Parties do not agree that the amount in controversy does not exceed (\*\*), or if the Dispute involves a claim for relief other than monetary relief, then the arbitration shall be heard and determined by a tribunal of three (3) arbitrators in accordance with the provisions of Article 19.4.3 or 19.4.4 (as applicable).
- 19.4.3 Disputes relating to matters with an amount in controversy of (\*\*) or more, but less than (\*\*) shall be heard and determined by a tribunal of three (3) arbitrators. The arbitration shall be conducted pursuant to the Rules of Arbitration of the London Court of International Arbitration (“**LCIA Rules**”). The seat of the arbitration shall be (\*\*). If the Parties do not agree that the amount in controversy is less than (\*\*), then the arbitration shall be heard and determined by a tribunal of three (3) arbitrators in accordance with the provisions of Article 19.4.4.
- 19.4.4 Disputes relating to matters with an amount in controversy of (\*\*) or more shall be heard and determined by a tribunal of three (3) arbitrators. The arbitration shall be conducted pursuant to the LCIA Rules. The seat of arbitration shall be London, England.

10.7 **Review of Contract Price**

The Contract Price shall be subject to review and adjustment pursuant to the terms of this Article 10.7:

10.7.1 By not later than thirty (30) days after each of the following dates:

- (a) the eighth (8<sup>th</sup>) anniversary of the Commencement Date (the “**First Price Adjustment Date**”); and
- (b) the eleventh (11<sup>th</sup>) anniversary of the Commencement Date (the “**Second Price Adjustment Date**”);

either Party shall be entitled, by written Notice to the other Party (the “**Price Adjustment Notice**”) to request a review of the Contract Price in accordance with the terms of this Article 10.7 (the “**Price Adjustment**”) if, in its opinion, the Contract Price as at the respective Price Adjustment Date does not represent the price appropriate for the selling to, and buying by, (\*\*).

10.7.4 If the Parties fail to reach an agreement on the Price Adjustment within ninety (90) days after the Price Adjustment Notice was delivered (or by a later date as may be agreed in writing by the Parties), either Party may refer the matter to Arbitration pursuant to Article 19.4.



# LCIA ARBITRATION RULES

## Recommended Clauses

### Future Disputes

For contracting parties who wish to have future disputes referred to arbitration under the LCIA Rules, the following clause is recommended. Words/spaces in square brackets should be deleted/completed as appropriate.

"Any dispute arising out of or in connection with this contract, including any question regarding its existence, validity or termination, shall be referred to and finally resolved by arbitration under the LCIA Rules, which Rules are deemed to be incorporated by reference into this clause.

The number of arbitrators shall be [one/three].

The seat, or legal place, of arbitration shall be [City and/or Country].

The language to be used in the arbitral proceedings shall be [ ].

The governing law of the contract shall be the substantive law of [ ]."

Request for Arbitration

Response

Written Communications and Periods of **Time**

Formation of Arbitral Tribunal  
Revocation and Challenges  
Nomination and Replacement

Communications between Parties and **Arbitral Tribunal**

Conduct of Proceedings  
Written Stage of the Arbitration  
Seat of Arbitration, Place(s) of Hearing and **Applicable Law**

Hearing(s)  
Witnesses  
Expert to Arbitral Tribunal  
Interim Measures  
Award(s), Correction of Award(s) and Additional **Award(s)**  
Confidentiality

## PRICE REVIEW ARBITRATION

- The **upstream suppliers often needed financing for the investment necessary to bring the gas to commercial production.** To ensure that the producers would be able to repay the money borrowed, banks required a guarantee -> **take-or-pay clause.**
- The buyer is obliged to pay for a pre-determined volume of natural gas, **whether or not that volume has been taken.**
- However, the buyers were exposed to significant risk – changed market conditions. Longer contract = higher risk. Thus, **Price Review Clauses have been added.**

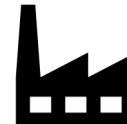


# PRICE REVIEW ARBITRATION

## Take-or-pay clause:

How to balance the risk of market volatility?

**NETBECK FORMULA** – gas price is tied to **traded gas prices** (for instance, in the US – Henry Hub. As result, it is ensured that the price remains aligned with the conditions under which the gas can be sold into the downstream market).



## PRICE REVIEW ARBITRATION

However, there were no gas hubs in Europe and no independent gas price reference.

*There was no competition among gas companies, there was usually only one – state-controlled energy company dealing with gas supplies.*

Thus, the only concern for energy companies – the buyers – was price of potentially competing fuels – oil (reflected by independent oil price benchmarks).

-> **PRICING BY REFERENCE TO OIL WAS THE BEST OPTION TO TRACK TO COMPETITIVE DYNAMICS OF THE DOWNSTREAM NATURAL GAS MARKET.**

**PRICE = a fixed based value + indexation component tied to oil /oil derived products.**



# PRICE REVIEW ARBITRATION

However, proxies are imperfect.

**Commodity markets are very volatile and there may be changes in gas markets that would not be reflected in oil markets!**

**PRICE REVIEW CLAUSE** (as an additional and complementary mechanism).

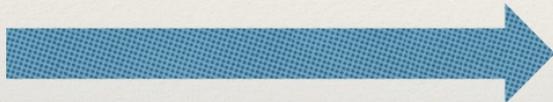
*Rationale:* If conditions underlying the commercial bargain significantly change over time, either party may seek **revision of the contract price.**



# PRICE REVIEW ARBITRATION

Historically, long term contracts were relatively stable.

However, when European gas markets were liberalised, new competitors entered gas markets and traditionally state-owned monopolists were facing a competition.



Gas market liberalization has significantly affected gas prices.

- 1) *Third party access*
- 2) *Consumers could newly choose their natural gas suppliers and to negotiate prices.*
- 3) *Unbundling*

**Objective: “as competition increases with the progressive development of the internal market for gas, prices are expected to fall.”**

For instance, Edison - a newly established company became an important competitor of Eni. New competitors signed contracts with gas producers and competed with other competitors to sell to the downstream market share. **DOWNSTREAM PRICES WERE NO LONGER SET BY THE SUPPLY PRICES BUT BY THE COMPETITIVE DYNAMICS IN THE END-USER MARKET ITSELF.**

# PRICE REVIEW ARBITRATION

FUEL COMPETITION

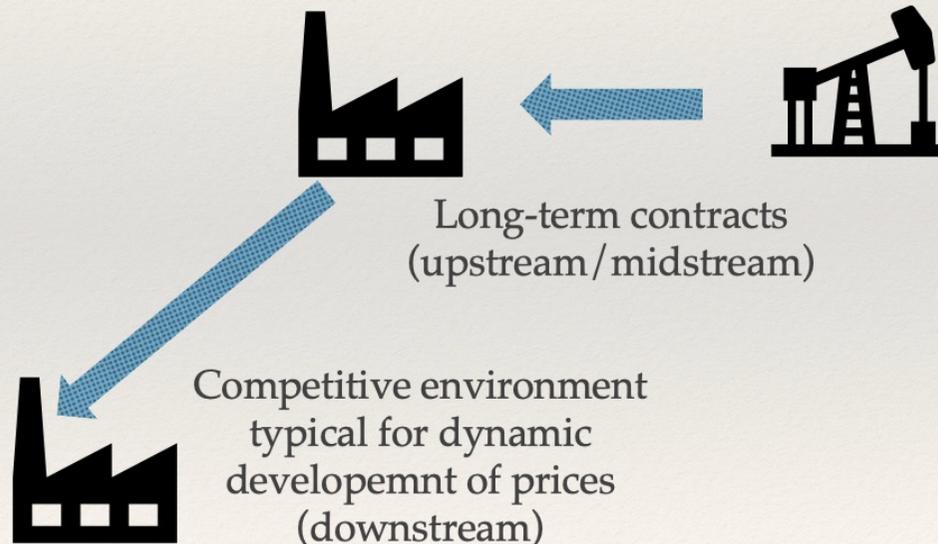


REAL COMPETITION

Oil / Oil products  
indexation became  
irrelevant.

Decoupling of the Oil  
and Gas Prices

A lack of connection  
between what the buyers  
were paying upstream  
and what the buyers were  
receiving downstream.



## Arbitration

### *(the first wave - liberalization of gas markets in Europe)*

- Tribunals lowered the contract price formula by introducing a “correction factor” to correct the decrease in the market gas price that the oil-linked contract price did not track, to reflect the gas-to-gas competition price in the market.

### **(the second wave – financial crisis 2008 and the US shale gas boom flooding global markets with US gas)**

- > influx of new quantities of natural gas increased liquidity in the European gas hubs. These hubs began to mature rapidly.
- EU gas hubs now act as a price-setting mechanism in the markets that they serve (GAS HUB INDEXATION) For instance, **Eni – Gazprom gas contract is now 100% hub indexed).**

## ARBITRATION

### 2012 Edison v. RasGas (Qatar) and Sonatrach (Algeria)

*(awards remained confidential)*

In 2012, Italian utility company Edison obtained awards of around €350 million from LNG supplier RasGas, and a similar amount from Algeria's Sonatrach, following gas price review arbitrations.

The award relates to **a 25-year sale and purchase agreement executed between Edison and Rasgas in 2003 for the supply of Qatari liquid natural gas** to an Adriatic regasification terminal, beginning in 2009.

## ARBITRATION

### Eni v. Statoil

In November 2013, Italian oil and gas group Eni claimed up to US\$10 billion from Norway's Statoil in a price review arbitration concerning a long-term gas supply agreement.

**Eni was able to reach a deal with Statoil before the arbitration tribunal reached a final decision.**

## ARBITRATION

### RWE v. Gazprom (2013)

#### ICC

US\$4 billion gas price review proceedings in a Vienna-based ICC arbitration under *Austrian law* brought by RWE Transgas the Czech Republic's national importer under a long-term gas supply agreement. **The Czech subsidiary of RWE had a 9 billion cubic metres (bcm)/year supply contract with Gazprom until 2035 with a 90% take-or-pay obligation.**

**The tribunal awarded RWE compensation for the resultant overpayment made since May 2010 and also adjusted the purchase price formula of the contract by removing the link to the oil price and substituting a link to gas spot prices.**

The revised price will be linked to what RWE called "**relevant conditions on the gas market at the time of the price revision in May 2010**".

## ARBITRATION

### Naftogas v. Gazprom

**On 19 January 2009, the Parties entered into a contract for the purchase and sale of natural gas for the period 2009-2019, the "Gas Sales Contract".**

Gazprom agreed to provide gas to Naftogaz at **a price linked to other petroleum products**. In addition to paying the contract price, Naftogaz agreed to a number of additional obligations, including most notably a **take-or-pay clause** and a **destination clause**.

**Take-or-pay clause:** Out of the annual contract quantities of 52bcm per year, Naftogaz had to **take at least 80% (42bcm)** a year, whatever the volume it required or used.

**Destination clause:** a provision precluding the purchaser from reselling the gas = Ukraine must be the 'final destination'.

*Relevant provision of the contract:*

**"4.4 If either Party declares that the fuel and energy market conditions have changed significantly compared to what the Parties had reason to expect at the conclusion of this Contract, and if the contract price provided in Article 4.1 of this Contract does not reflect the level of market prices, then the Parties shall enter into negotiations regarding an adjustment of the Contract Price in accordance with the provisions of this Contract.**

**4.4.1 A request for price revision shall be submitted in writing and shall be properly substantiated.** Upon receipt of the above-mentioned request by the Party concerned, the Parties shall enter into **negotiations** within 20 days and, if an agreement is reached, sign the respective addendum to this Contract.

**4.4.2 If a written agreement on the revision of the Contract Price cannot be reached within 3 (three) months from the date of the beginning of negotiations, each of the Parties has a right to dispute the other Party's performance of the present Contract and to submit the matter to arbitration in accordance with Article 8 of the Contract for the passing of a final decision.**

**Issues:**

- (1) Whether there was a right to price revision;
- (2) Whether there was a right to price determination and what that price determination should be;
- (3) Whether Gazprom has a right to take-or-pay payments; and
- (4) Whether one or more contractual provisions should be declared void or ineffective.

## Naftogaz v. Gazprom (2017)

In June 2014, both Naftogaz and Gazprom filed claims against one another in relation to the gas supply contract.

### **Commercial Arbitration: Stockholm Chamber of Commerce (SCC)**

#### **Naftogaz:**

- **Sought to review the price index retroactively** in order to claim the sums that had been allegedly **overpaid** to Gazprom starting in May 2011.
- **Requested the annulment of the destination and take-or-pay clauses which were no longer economically viable** given the shifts in the oil and gas market.

#### **Gazprom:**

- Claimed **damages for non-payment by Naftogaz and penalties under the take-or-pay clause due to Naftogaz's alleged failure to purchase the minimum volumes of gas specified in the contract.**

An award rendered in 2017,

- 1) **Naftogaz had a right to price revision**; the arbitral tribunal determined a new formula on the basis of the pricing mechanism seemingly linked to German Hub prices, taking effect from 27 April 2014.
- 2) The tribunal only revised the price as from 2014, thus **rejecting the retrospective aspect of Naftogaz's claim for overpayment**.
- 3) **Take-or-pay clause remained in force but was revised** to bring the minimum volume down from 42bcm to 4bcm a year.
- 4) The tribunal **excluded the retroactive application of the revised take-or-pay provision**.
- 5) **Several clauses were declared invalid (notably the destination clause, which had prohibited the sale of gas purchased under the Gas Sales Contract outside of Ukraine)**.
- 6) The arbitrators justified the revision of take-or-pay clause by reference to **market developments, namely oil-linked pricing no longer being the standard practice**.

**The tribunal ordered Naftogaz to pay damages in the amount of US\$2.02 billion for volumes not taken between 2010 and 2017 and applied a penalty of US\$600,000 a day for non-payment.**

# International Arbitration in the Energy Sector: COMMERCIAL ARBITRATION

