# Kluwer Arbitration Blog

## Crude Oil Prices – What Lies Ahead for Arbitration Lawyers?

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At above US$60 per barrel, crude oil prices have bounced a little since their January 2015 low. However, with continued mixed indications concerning US production, opinion remains divided on where prices will end up in the short to medium term. As the recent GAR Live Energy Disputes event (held at Clyde & Co's London headquarters on 6 May) confirmed, there is perhaps even less in the way of consensus on what lies ahead in terms of the medium-term effects on the energy industry and this uncertainty is necessarily echoed and amplified when it comes to disputes.

It is a maxim of modern legal practice that market volatility creates disputes. However, some panellists at GAR Live Energy Disputes predicted that this effect could be tempered in part by the legal budgets of those involved and, in extreme cases by their insolvency, frustrating final recovery of any sums due. With tighter legal budgets, more than ever clients will be keen to ensure that the likelihood of recovery is factored in from day one.

On the other hand, the size of the drop in crude prices has in many circumstances put billions of dollars in play and made the upside of formal dispute resolution more attractive. This suggested to some present an increase in bet-the-company cases and, more widely, that the average value of disputes may increase even if numbers do fall. It may even be said that an increase in the amounts at stake could stimulate formal proceedings, as parties take the view that proceedings are "worth a shot" in order to have a chance of significant gains while securing an end to the dispute at the same time.

The more mainstream view from within the industry is that when faced with a dispute, particularly over a contract which is especially commercially or strategically significant or of unusually high value, companies are putting considerable efforts into resolving matters without recourse to dispute resolution. This includes reaching agreements which harness existing market opportunities to the benefit of all parties, even when the subject matter of that agreement does not go to the heart of the dispute. This might manifest itself, for instance, in the arbitrage of LNG cargoes into higher priced markets, coupled with an appropriate profit share in order to offset market-related losses in a gas supply contract.

While existing and future commercial relationships do often need to be considered, some companies do not have that luxury when faced with severe financial difficulty and / or external events. It follows that contractual provisions concerning force majeure, change of circumstance and hardship are under increased scrutiny and the choice of law – which extends beyond a simple civil law versus common law choice – is increasingly important in this context. As ever, it pays to know where the vulnerabilities and opportunities lie before disputes arise.

In an industry where 20 year contracts are commonplace, many say it is too soon to feel the true effects of a downturn which hit its nadir only five months ago. Indeed, the consensus at the GAR Live Energy Disputes event appeared to be that gas pricing disputes – where a more sustained economic change is often needed to trigger a review or renegotiation clause in an oil-linked gas sales contract – were an area in which further disputes are very likely in the future if a comparatively low oil price remains. Perhaps ironically, given that many such arbitrations have been argued on the basis of a long-term decoupling of oil and gas prices, some of the first claims to be launched may be parties who now feel aggrieved because of "too much hub" (i.e. tied to the price of gas at various geographical hubs) in pricing formulae. Clyde & Co will analyse the possible effects of oil price changes on gas price arbitration in more detail in a forthcoming post.

It is clearer than ever that owing to the size and diversity of the companies and contracts in the industry, a tailored and textured approach is required when faced with issues arising from the present substantially lower oil price. Exploration and production contracts may be at different phases of development and may be based upon very different economic scenarios, with different break-even points. Some agreements which depend upon oil prices, such as oilfield services contracts and gas contracts with oil-indexation, may be insulated from the recent falls but unless the market recovers quickly, its effects will be felt there too. Overall, companies in the energy sector as a whole would be well advised to keep their contracts under review in the context of oil price volatility, so as to be best placed to anticipate and satisfactorily resolve any disputes which may arise before they become unmanageable.

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