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When Russian gas is turned off - do you have any recourse?

The news channels are currently awash with coverage of the Russia/Ukraine gas supply dispute. Tempting though it may be to comment on the broader politico-economic issues both behind and consequential on the dispute, we will restrict this article to two main legal issues that those adversely affected by the dispute may need to address:

1. the effect of gas supply cuts on contracts incorporating EFET General Agreement Terms (the "Terms") for gas supply; in particular the potential for sellers to avoid the obligation to deliver the gas by invoking the force majeure clause of the Terms, and/or the English doctrine of frustration; and
2. possible rights to arbitrate offered by the Energy Charter Treaty.

Force Majeure

The force majeure (FM) clause in the Terms contains nothing unexpected: it allows for the release of a seller from his obligation to deliver gas when it is impossible for him to do so due to an occurrence beyond his reasonable control and which he could not reasonably have avoided or overcome.

Does a cut in supplies caused by the Russia/Ukraine gas supply dispute fall within this provision?

The FM clause specifically excludes "curtailment or interruption of transportation rights or any problem occurrence or event affecting any relevant pipeline system unless it constitutes a Transportation Failure". Although the distinction is a fine one, this provision is not clear as to whether "curtailment" refers to transportation *rights* only or whether it means *interruption of supply* generally. In a telephone conference called by EFET to discuss this recent crisis, the majority of participants expressed themselves to be in favour of the first interpretation – i.e. that only the curtailment of *rights* is excluded by the FM clause – which in turn means that affected parties can rely on the FM clause in this situation.

Assuming that the circumstances arising from the dispute do fall within the FM clause, in order for the clause to bite, it must be the **delivery** of the gas which must be **impossible**. If the contract is silent as to the origin of the gas - as usually is the case under EFET - although it may be impossible at present to deliver gas from Russia through the Ukraine as anticipated, it may at least in principle be possible for the supplier to source gas from other regions. Nor does it help that the EFET contract would usually provide for delivery into a given transmission system without specifying an entry point. That could make it *possible* to perform the contract by making delivery at any entry point of the relevant grid.

The fulfilment of the impossibility requirement under the FM clause is therefore contingent upon the inclusion, as implied conditions of the contract, of the specific delivery terms the parties had in mind. The fact that, under the present circumstances, Siberian gas transported through Ukraine and Slovakia to Europe was the only product that could reasonably be bought and sold at the agreed contract price would be a strong but not conclusive argument.

English Doctrine of Frustration

If an FM claim looks as though it must be ruled out, is there a solution to be found anywhere else? A potential answer may be found in the form of the English doctrine of **frustration of purpose**. Frustration can arise where a contractual obligation has become incapable of being performed because the circumstances in which the performance is called for would render it radically different from that which was anticipated by the contract.

As noted in relation to FM above, theoretically it would be possible to source or supply gas from somewhere other than Russia via the Ukraine. In practice, doing so could amount to be such a radical change to the performance of the contract that it could be considered to be frustrated.

Frustration only applies where the situation has not been addressed elsewhere in the contract. Although the presence of the FM clause in itself does not necessarily exclude frustration from applying, where the circumstances leading to the claim for frustration are expressly covered by

the FM clause, it is clear that the parties have contemplated the situation, and frustration will not override the intentions of the parties.

If, however, the interruption of supply falls outside the scope of the FM, it can be argued that frustration may be invoked by the party due to receive the Russian gas under the EFET contract.

One final problem with the application of frustration to these events, is that depending on when the contact was agreed, it could be difficult to prove that the parties did not anticipate these kind of events in light of the fact that the Russia/Ukraine dispute has been ongoing since supplies were first cut in 2006.

It seems then that while frustration may be a runner, it faces some high fences.

Importantly for the present situation, frustration terminates a contract. If therefore a party seeks to claim frustration, it has also to accept that that the contract has gone forever. We suspect that, in most cases, this will not be the outcome that a supplier would want.

The Energy Charter Treaty

Gazprom's deputy chief executive Alexander Medvedev in an interview with *The Times* last week called for the creation of a "new international institution" to arbitrate in similar disputes stating that *"what we are missing is an international instrument that could prevent or help resolve such disputes"*. Mr Medvedev also said that Russia had proposed such an idea at a meeting of G8 leaders in St Petersburg in 2006 but that the idea had not progressed any further. It is open to speculation as to the motive for this statement in view of the fact that Russia is a member of the Energy Charter Treaty (the "Treaty") (albeit, it has not ratified the Treaty, on which issue, more below). This is a Treaty which specifically covers the kind of dispute that Russia is having with the Ukraine. Perhaps he forgot about it because it prohibits its members from cutting supplies across member borders as a means of forcing the issues in a dispute between those members (Article 7).

While the Treaty offers both Russia and the Ukraine a dispute resolution mechanism, this is of little or no comfort to those affected by the current symptoms of their dispute. But the Treaty offers a whole lot more…

The Treaty provides a framework for international energy co-operation and, among other things, for the Transit of energy without the imposition of any unreasonable delays or restrictions or charges ("Transit" is defined as being the carriage through one Contracting Party of energy products originating from another Contracting Party whether destined for that Contracting Party or a Third Contracting Party) – Article 7.

If, as it appears, both Russia and the Ukraine have breached the Transit provisions, "Investors" affected by the breach, (including companies/organisations registered in a Contracting Party supplying gas under a contract for remuneration) may be able to bring an action in the ICSID, UNCITRAL or Arbitration Institution of the Stockholm Chamber of Commerce against Russia and/or the Ukraine, to recover damages resulting from the breach.

However both the referral of an arbitration and the arbitration itself can be lengthy processes. Before the dispute can even be referred to arbitration, a request for amicable settlement must be made and only if this is not achieved within 3 months can the dispute be referred to the Secretariat of the Charter. Once referred, the arbitration itself can take a long time - for instance, some of the current Treaty cases that are at a preliminary stage, were registered in 2005.

The Ukraine has signed and ratified the Treaty and so is subject to all of its provisions. Russia, in contrast, has not ratified the Treaty. This means that in the current cases against Russia, all of them are bogged down in dealing with the initial and complex question of whether Russia can be subject to a Treaty-based arbitration because it has not ratified the Treaty. It may therefore be the case that Russia is not threatened by the potential of such arbitration claims. It is, however, encouraging to note that it was held in a similar case against Georgia that the whole of the Treaty must be applied as if formally in force, including the arbitration provisions, despite Georgia not having ratified the Treaty.

We have been championing the Treaty for some time now and we maintain that it has a great deal more to offer than many either recognise, or choose to remember.

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