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DISPUTE RESOLUTION WEBINAR

## The Ukraine conflict and the energy sector

The impact of sanctions and price  
volatility on contractual performance

10 March 2022

# Agenda

- 1 Sanctions: what's the current position?

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- 2 Price volatility: consequences for supply and sale agreements

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- 3 Managing contractual non-performance

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- 4 Questions

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# Speakers



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A wireframe globe of the Earth is the central focus, showing the continents of North and South America. The globe is overlaid with a network of white lines and dots, suggesting a global network or data flow. To the right, there are several financial charts: a candlestick chart at the top right, a line chart with an upward-pointing arrow in the middle right, and another candlestick chart at the bottom right. The background is dark with some light effects, including a bright spot on the left side of the globe.

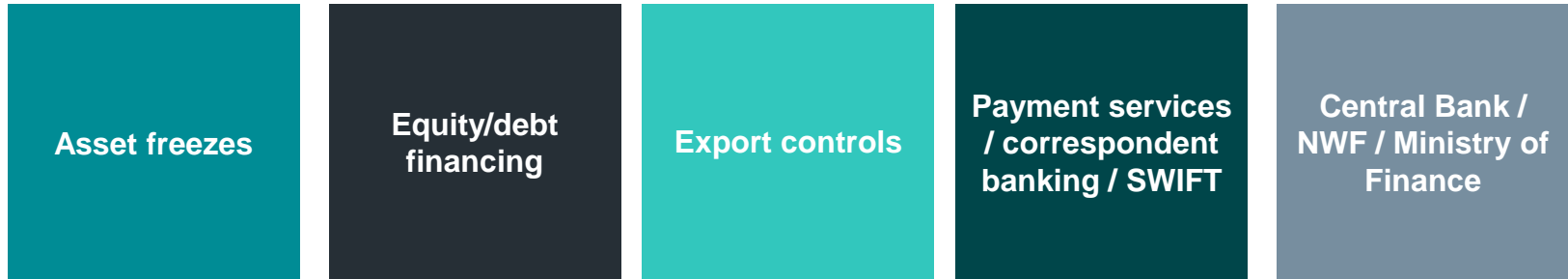
Sanctions:  
What's the current position?

Oil ▲2.45 ▼0.96

Index ▲1.56 ▼0.78

# Sanctions to date

- "International" sanctions on Russia since 2014
- Staged expansion since February 2022, response to heightened tensions, and Donetsk / Luhansk recognition
- Coordinated, but significant differences in regimes
- Main themes (not energy specific):



# Sanctions on energy industry

## 8 March 2022 announcements:

- UK: phase out Russian oil and oil products by the end of 2022
- US: ban imports into US of Russian energy products (plus new US energy sector investment in Russia)
- EU: REPowerEU – EU independent from Russian fossil fuels well before 2030
- Plus:
  - debt / equity related restrictions targeting Russian OilCos (and Gazprom – US)
  - debt / equity related restrictions targeting persons "connected with Russia" (unless outside Russia) – UK
  - technology and services to deepwater, Arctic, shale projects, and new restrictions on exporting goods for oil refining in Russia - EU/US
  - UK prohibiting Russian ships entering ports in UK
  - restrictions on Russian banks may affect payment to Russian oil and gas producers, as may restriction on access to SWIFT

# Roadmap for approaching sanctions issues

1

Which sanctions do you have to comply with as a matter of law?

2

Are proposed activities contrary to those sanctions?

3

Is counterparty targeted by an asset freeze, or owned / controlled by person that is?

4

Do sectoral sanctions (e.g. debt/equity restrictions) affect activities?

5

What about contractual obligations? Have you agreed to give effect to sanctions you are not otherwise obliged to comply with?

6

"Market sanctions" / derisking: going above and beyond sanctions due to (i) sanctions risk; (ii) reputational/moral concerns: contractual implications

7

US "secondary" or "extraterritorial" sanctions

8

Don't forget: export controls

# Enforcement

Under a number of systems (e.g. US and Australia), liability is strict for breach (but mitigation\defence is possible)

In some systems (e.g. UK and EU) violation only occurs where you had reasonable cause to suspect dealing with a designated person / breaching sanctions (although see: UK Economic Crime Bill 2022)

US has fined heavily a number of banks and a number of non-US banks

UK has fined mostly banks / financial services / fintech

After building complex systems of new sanctions, it would seem odd if the Western authorities did not seek to enforce them rigorously, and so we can expect that

Price volatility:  
Consequences for supply  
and sale agreements





# Price volatility

## URALS-BRENT PRICE DIFFERENCE



● Urals-Brent differential (usd/bbl)

Datasource: Thomson Reuters\*

# Price volatility

## DUTCH TTF GAS FUTURES



Datasource: ice

# Price volatility

## OIL BRENT



Datasource: Business Insider

# Gas sector issues

European reliance on Russian natural gas and low storage levels

Constrained global LNG supply

Limited EU regas facilities and difficulties of onwards transmission

Stratospheric gas and LNG price rises

Common use of spot and short term pricing in Europe of long term contract pricing in e.g. Japan, Korea

Impact of sanctions on already tight LNG carrier charter market

Volume flexibility, price reopener and non-performance incentive for long term GSPAs

# Pricing volatility impact

Already tight markets esp LNG, post-COVID price increases and incentives to maximise spot sales

Application of liability caps and volume flexibility; will liability caps hold?

Limited availability of price reopener clauses in short/medium term contracting

Alternatives e.g. competition law or hardship doctrine

Challenges re “economic force majeure”

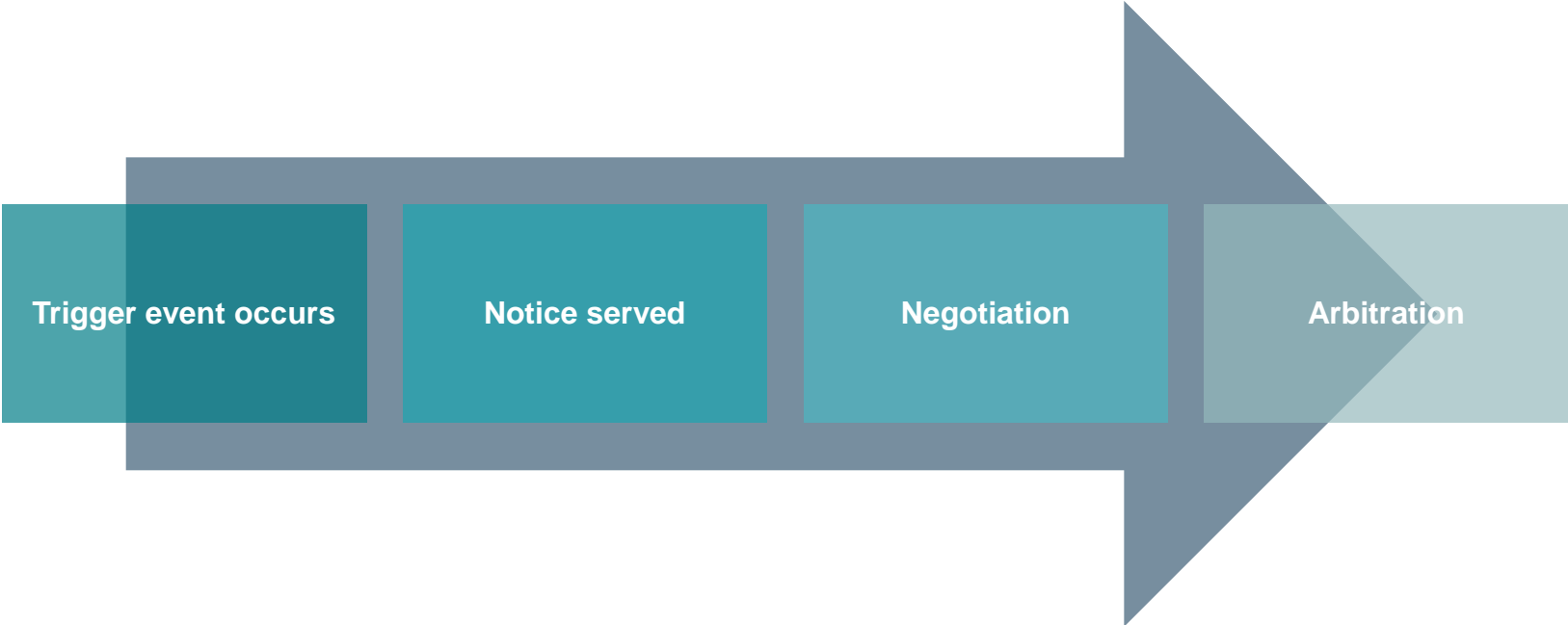
# Different types of price review clauses

**Periodic price review clauses**

**Special price review clauses**

**Often seen together.  
The special price review clause is sometimes referred to as a “Joker”**

# Price re-opener clauses



# Lessons to be learnt from European price reviews

**Notice provisions**

Obligations to negotiate

Trigger events

Confidentiality and privilege

**Economic and industry expertise**

Selecting an arbitrator

**The Tribunal's mandate**



# What if a Russian oil or gas embargo?

Russia a reliable supplier from 1980's until 2008/9 "gas wars"

Reduction in pressure, non-supply to smaller users – EU response e.g. interconnectors

But 40% of EU gas consumption 2021; epic scale of supply substitution

Emergency powers, feedstock and high-usage industries closed

Impact on friendly suppliers e.g. Australia, Gulf, Nigeria, USA (but European regas capacity?)

Impact on energy transition?



## Managing contractual non-performance

Contractual mechanisms

Dispute resolution and enforcement

Treaty protection

# Common law

## FORCE MAJEURE

- Creature of contract – not a separate doctrine (c.f. Civil Law)
- Starting point: always, what is contained in the contract
- **HOW** has the contract been impacted and **WHAT EVENT** has impacted the performance
  - How is performance impacted?
    - Often not enough that the contract has become inconvenient or more expensive to perform
    - Does the clause require that performance has become impossible, or merely hindered or delayed?
  - What event has impacted the performance?
    - Almost always a requirement that there is a causal link
- Is the conflict an “FM event”?
  - “War” / “armed conflict”
- Is it an event ancillary to the conflict such as sanctions, legislation, or other acts of government?

# Common law

## FORCE MAJEURE

### Practical considerations

- Follow notice provisions, time frames and other potential pre-conditions
- Continuing conditions, e.g. reporting

### Impact of invoking fore majeure

- Beware of termination rights

### Role of mitigation

- Example: AIPN LNG MSA: “*Reasonable Efforts*” means a Party’s efforts to meet its obligations but that do not require the performing Party to expend funds or assume liabilities other than expenditures and liabilities reasonable in nature and amount in the context of the obligations

# Common law

## CHANGE IN LAW AND FRUSTRATION

### Change in Law

- Contractual remedy
- Allocate risk at the outset

### Frustration

- Terminates the contract
- Without the fault of either party
- Contract physically or commercially impossible to perform

# Common law

## MATERIAL ADVERSE CHANGE AND VARIATION

### Material Adverse Change

- Context of mergers and acquisitions and corporate finance
- Buyer has the right to terminate prior to completion if the target is materially and adversely affected by certain events occurring between a specified point in time and the intended completion date

### Variation

- Potential amicable solution
- Particularly useful in supply agreements

# Common law

## TERMINATION RIGHTS

Parties may expressly provide for right to terminate

“Material” breach

Burden of proof on party seeking to terminate

Consider notice requirements

Repudiatory breach

# Civil law

## FORCE MAJEURE

Different to common law - separate legal doctrine

Suspends performance

Commonly provided for in civil codes

Established principles, guidance, authority

But often a higher hurdle – i.e. impossibility



# Civil Law

## HARDSHIP, FAILED ASSUMPTIONS ETC

Fundamental change of circumstances making performance excessively burdensome or onerous

Allows resetting of the economic equilibrium – i.e. renegotiated terms

NB ability for civil law to apply on a mandatory basis notwithstanding choice of e.g. English governing law

Is the power to renegotiate vested in one party? Is termination the default result?

Need to act swiftly

NB challenges of application in sophisticated commercial relationships

# Liquidated damages and liabilities caps

**Withhold supply, pay capped damages and sell at spot prices?**

**Can liability caps be challenged?**

**Do they hold at all where breach is deliberate?**

# Treaty protection

**83 Russian BITs, 64 in force**

**Energy Charter Treaty – signatory but not ratified**

## Protections offered

- protection from expropriation without compensation
- most favoured nation provisions
- national treatment provisions
- fair and equitable treatment
- full protection and security
- free transfer of investment and returns



Questions

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