Successive disputes under long term contracts: when can issue preclusion arise?

Those who draft very long term contracts face peculiar challenges. No amount of foresight can anticipate every conjuncture in which the agreement may have to operate. For this reason it is not uncommon for such contracts to include provision for the pricing mechanism to be subject to periodic review. Other techniques allow non-price terms to be reviewed in the light of changed circumstances.

Contracts incorporating review mechanisms of this kind are prevalent in the primary resource industries where up front capital investment can be very high and the viability of a project depends on having a dependable purchaser for the resulting production over much if not all of the life of the investment. Examples include depletion contracts in the oil and gas industry where the future output of an oil or gas field is sold on terms that will apply to deliveries over a period of 25 years or more. It is the same with life of mine contracts for minerals including coal where part of the package on which the initial capital investment depends includes a long term contract for the sale of the mine's output over many decades. Similar review mechanisms can be found in long term Power Purchase Agreements in the electricity industry which are linked to capital investment in new power plant.

These are industries in which the value of the product as measured by its market price can be expected to shift significantly during the life of the contract. Nobody expects the price of gas, coal or electricity to remain flat for 25 years. Typically the parties to very long term contracts for these commodities will index the price to published statistical price indices. But these have their problems. The indices may cease to be published; or be re-based; or cease to be linked to the value of the commodity being sold in a consistent fashion. This kind of difficulty may be addressed in a genus of contractual adaptation clause known as the price review clause.

Difficulties may also arise with non-price terms. Over the long term the supplier's cost base may be destabilized by changes in regulation or input taxes. Sometimes the parties will have incorporated a review mechanism which allows the contract to be adapted to this kind of change.

I will describe such contractual provisions compendiously as "contract adaptation clauses". For a litigator they generate issues - some familiar and others less so. Many such clauses are in the nature of "agreements to agree". From my experience an argument that the clause is unenforceable may be slow to gain traction at any rate in the kind of international arbitral forum to which disputes tend to be referred.

An area of contention on which I wish to focus is issue preclusion. It is inherent in contractual structures incorporating adaptation clauses that successive disputes involving similar issues may arise between the same parties at different times during the life of the contract. Indeed many such contracts expressly provide for periodic review of eg., price, every four or five years. To what extent are the parties

(and likewise a court or tribunal) bound by findings made in a previous award or judgment relating to a previous review?

Because contracts of this kind tend to be between international parties arbitration as a method of dispute resolution is commonplace. The place of arbitration may differ from the place of performance. The proper law of the contract may be from a common law tradition or a civil law one.

All systems of law have rules for preventing the re-litigation of matters which have been previously decided. They are commonly discussed under the rubrics of res iudicata, issue estoppel and issue preclusion.

I shall be setting the scene with a few examples. I will then identify the kind of issue which may arise on successive occasions before turning to an analysis of the possible solutions. I will deliberately focus on the international context in which the questions are likely to arise. I will assume that dispute resolution is more likely to be vested in an arbitral tribunal rather than national courts.

Issue preclusion in the context of contract adaptation clauses – why it matters

The application of rules which preclude re-litigation in the context of successive reviews under contract adaptation clauses is not just of academic interest. I will be concentrating on two situations which can and do arise in practice. The first is concerned with contractual reviews of the pricing mechanism and the second with reviews of non-price terms.

Prior to 2003 there had been a long period of relative stability in the international energy markets. At that time contested price reviews were unusual. From around 2005, changes in the energy markets spawned what I will call a "first generation" of price review arbitrations, many of them under contracts which still had several decades to run.

Five or more years later when the oil price was high the pricing arrangements determined by arbitrators four or five years previously as part of that first generation of awards, themselves came up for further periodic review in accordance with the same contractual language and criteria. Over the last few years a yet further generation of price reviews is having to grapple with the consequences of a lower oil price environment. It is convenient to refer to these as "second" or even "third generation" price reviews.

My second example is concerned with statutory interventions designed to mitigate climate change. Over the years in the UK alone there have been a plethora of rules, levies and policy instruments, including the Fossil Fuel Levy, the Climate Change Levy, the Renewables Obligation and carbon trading. Of these only the last two remain current but their predecessors have sometimes left their mark in awards and decisions under long term power purchase agreements which remain in force. In other countries the regulatory and fiscal mix has varied but with a similar potential to impact on the economics of a long term transaction.

Contract adaptation clauses in power purchase agreements often provide for *changes* in the cost of compliance with taxes, levies and other imposts to be passed through to the purchaser. For these purposes the Renewables Obligation[1] in the UK is an instrument which serves to illustrate a wider problem which can arise in similar guise elsewhere.

In the UK generators of electricity from renewable sources are permitted to issue tradeable documents called "Renewables Obligation Certificates" (known "ROCs") for each unit of renewable electricity generated. ROCs have a value because all licensed electricity suppliers are required to produce to the regulator such number of ROCs as corresponds (in volume terms) to a prescribed annual percentage of their total supplies. Suppliers can acquire ROCs in various ways. They can build or acquire renewable generating plant. They can acquire electricity from generators of renewable plant with the ROCs attached. They can acquire ROCs from generators of renewable electricity without acquiring the associated electricity. Or they can acquire ROCs in the secondary market in which these instruments are traded. The costs associated with each approach will differ. As with any tradeable instrument the market value of a ROC can go up and down.

The legislation also permits a licensed electricity supplier to discharge its renewables obligation in whole or in part by making payment of a prescribed amount (per MWh) to the regulator. This amount is known colloquially as the "buy-out price" because it enables the supplier to buy its way out of the renewables obligation. Monies paid to the regulator by way of buy-out price are ring-fenced. The regulator is required to pay them over to generators of renewable electricity in proportion to the volume of such electricity that each has generated.

In practice the "buy-out" price acts as a ceiling on the market value of ROCs because a supplier will not normally choose to discharge its renewables obligation by acquiring and redeeming ROCs if it can buy its way out of the renewables obligation for less.

A contractual pass through of the costs of compliance with the renewables obligation can be problematic for three reasons. Firstly, particularly with legacy contracts which pre-date the obligation, there can be argument as to whether the renewables obligation is covered by a contract adaptation clause at all. Secondly, even where it is clear that the obligation is covered by the contract adaptation clause, it will generally only be the cost consequences of *changes* in the obligation which can be passed through to the buyer. Thirdly, because the obligation can be discharged in so many different ways (each with their own cost consequences) there is much scope for debate as to what cost consequences should be the subject of a contractual adaptation.

As with price reviews, issues of the kind just described can arise on successive occasions between the same parties during the life of a single long term contract.

---

[1] Renewables Obligation Order 2015/1947

Issue preclusion: an overview of the legal issues in an international context

Building on the above examples, I propose to start with successive price reviews and then turn later to successive reviews of non-price terms.

Tribunals appointed under "second" or "third generation" price reviews face an interesting question: should they be approaching their task with a blank sheet of paper or are they in some way constrained by what happened during the "first generation" review process?

There is often an international element which impacts on the answer to this question. Many long term gas supply contracts involve buyers and sellers from different countries; the place of delivery may be at an international boundary; international arbitration as a means of dispute resolution is commonplace. As noted earlier the place of arbitration may differ from the place of supply; likewise the choice of proper law.

Although the rules which apply to prevent repeat litigation differ from place to place, comparative law studies have demonstrated that there is a considerable element of common ground. Most systems of law only perceive a problem where there is an identity of parties on each litigious occasion together with substantial overlap in the claims made and the grounds of claim.[2] In a long term gas supply context the requirement of an identity of parties is normally satisfied. The parties to the contract remain the same from one price review to the next.[3] What is more interesting in the present context is the approach to the other questions. Virtually all systems of law accept that the dispositive part of an arbitration award, such as allows or dismisses the claim, will operate to preclude further arbitration or litigation about that self same claim.

More difficult are cases concerned with the grounds on which an earlier claim has either succeeded or failed: should the contracting parties be prevented from re-arguing a point which only ever featured as part of the reasons for, rather than the dispositive part of the earlier award? Further in a case where a claim or defence could be put in several different ways and only one of those alternatives has been considered on the first occasion: can a claimant (or defendant) have a second bite at the cherry by trying to reformulate its claim or defence on a subsequent occasion?

In the English common law jurisdictions the underlying philosophy is to view these questions in terms of an "abuse" of the court or arbitral procedure. Just as it is an abuse to re-litigate the same claim twice so likewise it is an abuse to raise on a second occasion an argument that could and should have been raised on the first occasion.

---

[2] This is sometimes referred to in comparative law studies as the "triple identity test".

[3] The contract may have been assigned between one price review and the next pursuant to a liberty contained in the agreement. Most systems of law take the "identity of parties" as being satisfied where there is identity between the parties "or their privies". The privy of an assignor will include its assignee.

In some civil law jurisdictions the rules are more mechanistic and focus on the terms of the disposition in the first award. The reasons are less likely to be binding in a subsequent arbitration and there is no scope for complaining about a point which the opposition could have taken previously but chose not to.

Because the analysis may differ from one legal system to another it also becomes necessary to consider what system of law should take precedence in a particular arbitration proceeding – in other words to engage in a debate about the relevant conflict of laws principles.

Space does not permit a detailed comparative law study of these topics and in any event my primary objective here is to focus on the application of general principles to successive price reviews. But for those who wish to probe deeper there exist two excellent comparative law sources to which reference should be made where issue preclusion arises in international arbitrations concerned with with successive price reviews. The first is to be found in the Interim and Final Reports on Res Iudicata and Arbitration of the International Law Association following the Berlin and Toronto conferences of 2004 and 2006. These can be found on the ILA website. The second is the 2013 Hague Academy lectures by Kai Hober which are to be found in volume 366 of the Recueil des Cours of the Hague Academy of International Law at page 103.

The position in relation to the subject matter and grounds of claim can, I suggest, be summarised as follows:

a. The question whether an arbitrator is bound by a decision of an earlier Tribunal is generally characterised as a procedural matter. It will normally therefore be determined by reference to the law which governs the procedure rather than the governing law of the contract. So if the governing law of the gas supply agreement is English law but the arbitration is taking place in Geneva in accordance with Swiss arbitration law it is to Swiss law rather than English law that the Tribunal should be looking for guidance on whether it is bound by say, a previous Geneva Award under the same contract.

b. There is a considerable body of opinion in international arbitration circles that it is unsatisfactory for the outcome of a debate about issue estoppel to depend on where the arbitration happens to have its seat. That was the view of the jurists who prepared the two ILA Reports referred to above. The ILA recommended a *transnational* approach to these questions and set out in three short paragraphs the circumstances in which an earlier Award should have "preclusive effect" in subsequent arbitration proceedings. I will call these the ILA recommendations. I will come back to them in a moment.

c. The ILA approach rested primarily on the policy reason already identified – namely the desirability of uniformity in the approach of international arbitrators when faced with successive arbitrations on

overlapping issues. But the ILA also noted an alternative basis for vindicating its recommendations. Under most institutional arbitration rules (and indeed under many ad hoc arbitrations) (a) the arbitrators are obliged to give reasons for their Awards and (b) by undertaking, as a matter of contract, to implement and give effect to the award the parties are agreeing to abide by the reasons as well as the disposition made in the award. The argument is that a solution which is in effect transnational, derives its authority from the parties' agreement itself. It is neither necessary nor desirable to look to national law for a solution.

d. Consistently with the above analysis, the ILA recommendations require a subsequent arbitration panel in a dispute between the same parties to treat the parties as being bound by the "determinations and relief contained in the dispositive part [of the previous award] as well as all reasoning necessary thereto".[4] Those recommendations would also prevent a party raising an issue of fact or law in the second arbitration which could have been but was not raised in the first arbitration if to do so would be procedurally unfair or an abuse.[5]

Application to successive price reviews: decisions on the interpretation of the price review clause

So much for overarching legal principles: how do they tend to be applied in the two examples which I identified earlier? I shall start with successive price reviews between the same parties under the same contract. What kind of issues can arise repeatedly? An obvious example is debate about the meaning of the price review clause itself. This is frequently controversial.

I have seen forms of price review clause in gas sales agreements which require the new price to be set at a level which permits the gas to be marketed "economically in the *end user* market of the buyer". Is the "end user" the person to whom the buyer intends to sell the gas - including for example – a local distribution company? Or does the end user mean the person who consumes the gas by burning it?

The answer to a question of this kind ought to be the same whether it arises on the first, second or subsequent price review under the same long term supply contract. If an Award on the first price review has included in its reasons a conclusion on what the "end user" means then in my view it would not be open to the parties to argue for a different meaning on a subsequent price review.

What I have said would, I suggest, be the right analysis under English law. In related price review arbitrations between the same parties in which I was involved in London it ultimately became common ground between those parties

4 ILA recommendation 4.
5 ILA recommendation 5.

that neither of them could properly contradict what the first tribunal had decided on a narrow issue of contract interpretation.

It seems to me that the same result would follow if the second and subsequent tribunals had chosen to implement the ILA recommendations. The reasoning in the earlier award would have preclusive effect and neither party could contradict it later.[6] My understanding is that it is at least possible in some civil law jurisdictions that the answer might be different particularly where a narrow view is taken of the dispositive part of the award to which the res iudicata principle applies.

Application to successive price reviews: decisions on the facts

Here I think the answer is likely to be different. In most price reviews one is comparing the price generated by the existing formula against current market information. It is almost inevitable that this factual comparison will be different in each successive price review. Firstly the existing formula will be different on each successive occasion (at any rate assuming that the formula was changed upon the previous price review). Secondly it is in the nature of current market information that it changes over time. The evidence and information on a second price review is never going to be identical to that on the first review.

It follows that the outcome of the first review cannot have preclusive effect in relation to the facts because the issue on the second review is different. Take a contract made in 2008 with four yearly reviews, and thus a first review in 2012 and a second review in 2016. The factual issue on the first review involved a comparison of the price being generated by the 2008 formula with market information from 2012. The issue on the second review will have involved a comparison of the price being generated by the 2012 price formula with market information from 2016. These are different issues and raise different questions. I do not see how the factual reasons given by a tribunal ruling on the 2012 review can bind the parties in relation to the different facts of 2016.

The same conclusion follows under the ILA Recommendations. The claim for relief would not be the same in each arbitration. In the first it would be a claim to set a new price as at 2012; in the second arbitration to set a new price at 2016. The factual issues would not be the same.

The only proviso I would make is this: it would be possible but unusual to have a factual sub-issue which might be identical in two successive arbitrations. An example relates to what I said earlier about decisions on the interpretation of the price review clause. If the interpretation of the clause involved looking at the evidence from the contract negotiation stage and making fact findings about this, it is conceivable that such findings might give rise to an issue estoppel both under English law and under the ILA recommendations.

---

6 ILA Recommendation 4

Application to successive price reviews: the discretionary element of the decision making process

Price review clauses typically include both a trigger event and an obligation to arrive at a new price by reference to contractual criteria. It is rare for the criteria to be expressed in a way which can be applied mechanistically to arrive at one and only one "correct answer". The parties, and in default of agreement the arbitrators, are frequently enjoined by the price review clause to have regard to a list of factors or in other cases simply to restore the contractual equilibrium reflected by the original formula.

To a lawyer from a common law tradition it is conventional to describe contractual language of this kind as giving the arbitrator a discretion over the choice of replacement formula. Indeed in some English law price review clauses words such as "discretion" or "just and equitable solution" are sometimes used. This is a discretion which must be exercised judicially in the sense that only the contractually prescribed criteria may be taken into account and non-contractual criteria must be left out of account. In civil law traditions other language is sometimes used but the practical effect is the same. The arbitrator has a margin of manoeuvre within which there is no single correct answer but rather a range of acceptable answers. Within that range the arbitrator can pick and choose.

If, in a first generation review, a tribunal has opted for a particular solution within a range of permissible options, then in my view it would be wrong to hold another tribunal seized of a second generation review, to the same choice. In this kind of situation an argument based on issue preclusion would be extremely difficult under almost any system of law as well as under the ILA recommendations.

Firstly the facts that the arbitrator would be weighing up in his decision making process on the second generation review would almost inevitably have changed in some way since the first generation review. Secondly, even the most detailed reasoned award will not ascribe a precise weight to each component of the decision making process. Those charged with determining the second price review would have no way of knowing how much emphasis the previous tribunal had placed on each point particularly where there had been subtle changes in the underlying facts.

In summary it is simply in the nature of this kind of decision that it is not susceptible of giving rise to issue preclusion unless the same factual inquiry is being made by *reference to the same point in time*. It is in the nature of successive price reviews that they are not made by reference to the same review date.

Application to successive reviews of non-price terms: decisions on the interpretation of the contract adaptation clause

At this point I will turn to the second of the two underlying examples I identified earlier. I am assuming a case where the contract provides for review where changes in the fiscal or regulatory environment have a significant impact on the supplier's cost base. I shall assume that a previous tribunal had to determine

whether a change in the Renewables Obligation triggered the review clause and if so with what consequences. As a result of yet further changes in the Renewables Obligation a different tribunal is now seized of the question whether further changes should be made to the contractual structure to take into account the most recent changes in the regulatory environment.

Once again my view is that a previous decision on the interpretation of the contract adaptation clause ought to continue to bind the parties at any rate to the extent that it remains relevant to the new dispute. Thus for example a decision as to whether the Renewables Obligation comes within the scope of the clause at all would, I suggest, be binding on both parties in a subsequent dispute in which exactly that issue arose again. The same issue of interpretation could arise again if the statutory structure of the Renewables Obligation had remained un-changed and only the details had been revised. But it is possible to envisage a statutory overhaul in which support for renewables was re-cast in a way which raised different issues of interpretation of the contact adaptation clause. In such a case the decision of the previous tribunal would have nothing to bite upon.

Application to successive reviews of non-price terms: decisions on the facts and decisions involving an element of discretion

In principle there should be no difference for issue preclusion purposes between these situations and the equivalent as it arises with successive price reviews. What I said earlier should apply likewise here.

Res iudicata and the confidentiality of the previous arbitration

Many systems of law and many arbitration rules require the parties and the arbitrators to keep the proceedings and the award confidential. This does not however prevent a party referring to an award in order to protect or pursue a legal right.[7]

This does not stop an award on a first price review being referred to in a second price review even if that involves showing the award to a tribunal made up of different people.

As explained earlier the parties are obliged to carry into effect the first award. If one of them fails to do so the other must be allowed to refer to the first award in order to enforce its rights. The position for issue estoppel purposes is no different to active enforcement -e g. by converting the award into an order of a court.

In New York Convention countries this conclusion is reinforced by Article III of that Convention. The Convention goes to recognition as well as enforcement. One

[7] See eg., Article 30.1 of the LCIA Arbitration Rules; *Emmott v Michael Wilson & Partners* [2008] 1 Lloyd's Rep 616 at para. 107; *Westwood Shipping v Universal Schiffahrtsgesellschaft MBH* [2013] 1 Lloyd's Rep 670 at para. 14.

of the processes by which an earlier award is recognised is by acknowledging the preclusive effects which the first award has on what can and cannot happen in the second arbitration. Just as confidentiality is not a bar to the enforcement of an award so it is no bar to its recognition.

Previous review determined by agreement

Sometimes the parties start an arbitration under a contract adaptation clause and at some point their dispute is resolved by an agreement which is incorporated into a consent award. Thus for example there may have been a first generation price review which was resolved on terms incorporated into a consent award. Later a different tribunal is seized of a second generation price review. I am occasionally asked whether issue preclusion can ever apply in this kind of situation

The short answer is that any issue preclusion or issue estoppel is likely to be academic because the consent award will generally have done no more than confirm the terms of the parties' agreement by which they are bound anyway.

Obviously the terms of the agreement must be honoured by the parties. It would however be unusual for the agreement to include a statement of agreed reasons for the agreed outcome. More typically an agreed outcome of a price review will do no more than identify the new price formula that is to apply from the review date.

Conclusion

Review clauses in very long term contracts can give rise to successive disputes which have much in common one with another. As a matter of principle issue preclusion can arise where a first dispute has been determined by an Award and a second such dispute is referred to arbitration. In general the preclusive effect of the previous Award will tend to be confined to decisions on the interpretation of the contract including its review wording. It would be unusual for an issue estoppel to extend to fact findings made in the previous award.

DAVID MILDON QC

April 2018