JUDGMENT : Mr. Justice Moore-Bick : Commercial Court. 31st March 2004

1. The applicant, Esso Exploration and Production UK Ltd ("Esso"), is a member of the well-known Exxon group. The respondent, Electricity Supply Board ("ESB"), is the Irish state-owned electricity generating company which operates a combined cycle gas turbine power station at Poolbeg near Dublin.

2. On 27th November 1997 Esso and ESB entered into a contract for the sale and purchase of certain quantities of natural gas each year for a period of 15 years from the date when deliveries began. In the event that was 1st October 1999. The contract provides for adjustments to be made from time to time in the price payable for gas supplied under it and a dispute has arisen between the parties as to the meaning of certain of those provisions. Esso has sought to refer that dispute to arbitration, but ESB has challenged the arbitrators' jurisdiction on the grounds that certain prerequisites to a valid reference to arbitration have not been satisfied. The matter comes before me by way of an application by Esso for a declaration that the tribunal has jurisdiction to determine the dispute. It is made under section 32(1) of the Arbitration Act 1996 with the consent of ESB.

3. The contract in question is lengthy and complex, but for the purposes of the present application it is only necessary to refer in any detail to some of the provisions of clause 12 which deals with the price and the manner in which it is to be adjusted during the period of the contract.

4. The price itself is made up of two elements, an Energy Charge and a Delivery Point Capacity Charge. Only the terms dealing with the adjustment of the Energy Charge are relevant for present purposes. Clause 12.2 provides that the Energy Charge is to be reviewed and adjusted every 6 months by reference to four markers: (i) the price of gasoil (30%), (ii) the price of low sulphur fuel oil (30%), (iii) the price of natural gas (30%) and (iv) the rate of inflation in Ireland as reflected in the industrial wholesale price index (10%). In each case the relevant marker is the average over the 12 month period ending 3 months prior to the review date. The prices to be taken for the three commodities are in effect the spot prices for delivery North West Europe.

5. The Energy Charge contains two elements: an amount expressed in pence per kilowatt hour ("P_o") and an amount in respect of transportation. Clause 12.6 records that the parties had fixed the initial value of P_o by agreement at a level that reasonably reflected the market price at the date of the agreement obtainable for the sale of reasonably similar quantities of gas over a reasonably similar period on reasonably similar terms and conditions between parties of reasonably similar commercial and financial standing for use in a reasonably similar type of power station in the UK or Ireland.

6. In addition to the automatic review and adjustment provided for by clause 12.2, clause 12.6(1) allows the parties to give Price Review Notices requiring a separate review of the Energy Charge at carefully regulated intervals throughout the life of the contract. By clause 12.6(6) a Price Review Notice cannot be given by the seller unless *". . . . . it is reasonably satisfied in good faith that the Energy Charge . . . . . is at the time of giving such Price Review Notice eighty five per cent (85%) or less than the Comparator."*

7. The Comparator referred to in clause 12.6(1) is defined in the opening section of clause 12.6 as follows: *"The market price . . . . . at the date of the relevant Price Review Notice for natural gas being supplied on the basis described above . . . . . ",* that is, on the basis of the sale of reasonably similar quantities over a reasonably similar period on reasonably similar terms and conditions between parties of reasonably similar commercial and financial standing for use in a reasonably similar type of power station in the UK or Ireland.

8. By paragraph (8) a party giving a Price Review Notice is obliged to specify in the notice itself the value of the Energy Charge which it is requesting; it is also obliged to provide the other party with a reasonably detailed explanation of how it has reached that figure and to provide it with all reasonably available published and other non-confidential information to support its position. The parties are then to negotiate with a view to agreeing an adjustment to the Energy Charge, but in default of agreement within 90 days the Price Review Notice must be withdrawn or the matter referred to arbitration to determine the Comparator and the consequent adjustment to the price.

9. On 1st November 2002 Esso wrote to ESB giving notice under clause 12.6(1) that it required a review of the Energy Charge. In that letter it stated that it was reasonably satisfied in good faith that the Energy Charge was 85% or less than the Comparator and gave its explanation for reaching that view. From that explanation it was apparent that it had determined the value of the Comparator by taking the price quoted in the Heren Report for delivery of a fixed quantity of natural gas to be delivered daily at the Bacton terminal for a period of a year (which it considered to be a generally recognised base market indicator) and adjusting it to reflect the particular terms of the contract with ESB.

10. ESB rejected Esso's Price Review Notice on the grounds that it did not comply with the contract. Its detailed reasons for rejecting it were not explained as clearly as they might have been at the time, but it has now become clear that its objection is based on the fact that the Comparator adopted by Esso is based on the market price for deliveries over 12 months rather than on prices actually being paid in the market for gas being supplied under long term sale contracts. In these circumstances the parties were unable to reach agreement on an adjustment to the Energy Charge and arbitrators were appointed. However, ESB maintained that, since Esso had used the wrong Comparator, the Price Review Notice was invalid and therefore no dispute had arisen of a kind contemplated by the contract. Accordingly, there was no dispute capable of being referred to arbitration and the tribunal lacked jurisdiction. In those circumstances Esso made this application to the court.

11. The dispute between the parties falls within a very narrow compass. It ultimately turns on the construction of the second sentence of the opening section of clause 12.6 which defines the Comparator, although both parties pray in aid the nature of the contract and what they suggest are the underlying commercial considerations. Esso says that the purpose of clause 12.6 is to ensure that the Energy Charge does not become too far out of line with the current market price for natural gas. Accordingly, if it is not possible to obtain evidence of the price being paid in the market for long term supplies of gas for power generation under contracts between first class sellers and buyers, an appropriate "market rate" should be calculated by taking the prices being paid for short term supplies and making suitable adjustments. ESB, on the other hand, says that the Comparator is defined as the market price for natural gas actually being supplied under contracts between similar parties on similar terms for similar purposes. If, as seems to be the case, there is currently no market for long term supplies, the Comparator does not exist and no adjustment to the Energy Charge can be made under clause 12.6.

12. Although Esso is seeking a declaration that the arbitrators appointed in this case have jurisdiction to determine the amount of the Comparator under paragraph (11), the real dispute between the parties relates to the construction of clause 12.6 and the true nature of the Comparator. The line between the nature of the Comparator and its amount may be a fine one, but in my view the jurisdiction of arbitrators appointed pursuant to paragraph (10) is limited to determining its amount. Accordingly, I do not think that they have jurisdiction to determine the question now in issue in any event.

13. Both parties have proceeded on the assumption that the service of a valid Price Review Notice is necessary if the arbitrators are to have jurisdiction to determine the amount of the Comparator under paragraph (11) and it is for that reason that argument has been directed to the validity of Esso's notice. In my view that is correct. The arbitrators' jurisdiction, as I have pointed out, is limited to determining a dispute that falls within the terms of the contract and has been properly referred to them. The mechanism leading to the creation of a dispute of that kind begins with the service of a Price Review Notice. If a notice is given that does not in substance correspond with the requirements of the contract, it is invalid and ineffective and the other party is free to ignore it. It follows that none of the machinery for determining the Comparator can be invoked against him, no dispute can arise that is capable of being referred to arbitration and any arbitrators appointed to determine the amount of the Comparator will necessarily lack jurisdiction.

14. The terms governing the service of a Price Review Notice are set out in paragraphs (1)-(8) of clause 12.6. One question that arises is whether compliance with paragraph (6) is a pre-condition to the validity of the notice. Mr. Rabinowitz Q.C. on behalf of Esso was inclined to accept that it is, though he submitted that the requirement that the seller be reasonably satisfied in good faith that the Energy Charge has fallen to, or below, 85% of the Comparator is essentially subjective in nature. Accordingly, if the information available to the seller has given rise to a reasonable level of satisfaction on his part that the Energy Charge had fallen to that level, the notice is valid even if in reaching that view the seller has applied the wrong test.

15. Mr. Howard Q.C. for ESB did not accept that construction of paragraph (6). He submitted that the expression *"reasonably satisfied*" means "*satisfied on reasonable grounds*". I think that is right. If the parties had wished to impose a purely subjective test it would have been sufficient to require the party giving the notice simply to be satisfied in good faith that the relevant circumstances existed. To go further and specify the necessary degree of satisfaction would be surprising and largely pointless; it would also give rise to an unnecessary element of uncertainty and consequent difficulty of application. An element of objectivity, however, in the form of the existence of reasonable grounds for satisfaction has the merit of providing a degree of protection to the other party by ensuring that there is a proper basis for putting the machinery of clause 12.6 into motion.

16. The right to give Price Review Notices is tightly controlled by paragraphs (2)-(5). Both parties have the right to give such notices, but only four in all can be given throughout the life of the contract and those at carefully defined intervals. Accordingly, unless it is later withdrawn, a notice given by one party, whether it results in an adjustment to the Energy Charge or not, necessarily affects the rights of the other, both as to the number of notices that it can give and as to their timing. That makes it much more likely, in my view, that the parties intended that the procedure should only be invoked when circumstances really justified it and one obvious way of achieving that end is to require the party giving a notice to have reasonable grounds for doing so. That conclusion is reinforced by the terms of paragraph (8) which requires the party giving the notice to explain how it has determined the adjustment to the Energy Charge it is seeking and to support its case with all reasonably available published and other non-confidential information. I conclude, therefore, that the expression "reasonably satisfied" in paragraph (6) means "satisfied on reasonable grounds".

17. The next question is whether, as Mr. Howard submitted, a Price Review Notice given contrary to the terms of paragraph (6) is invalid and ineffective. Clause 12.6 does not directly address that question, but the terms of paragraph (6) suggest that the existence of circumstances that are capable of justifying the conclusion that the existing Energy Charge has diverged to the necessary extent from the Comparator is intended to be a pre-condition to the right to invoke the procedure. It is highly desirable, of course, that the validity of a notice of that kind should be apparent on its face, but in the present case the requirements of paragraph (8) ought to ensure that it is. I find it difficult to accept that the parties intended that a Price Review Notice given in contravention of paragraph (6) was to count as one of the four notices allowed by paragraph (5). Equally, I find it difficult to accept that they intended that the procedure in paragraphs (9)-(12), including, where necessary, arbitration proceedings, could effectively be set in motion unless there were circumstances to justify it. Indeed, the opening

paragraph of clause 12.6 states that the Energy Charge shall be subject to review "*in either of the circumstances as defined in paragraphs (6) and (7) of this clause*". I agree with Mr. Howard, therefore, that a Price Review Notice given by a party who does not have reasonable grounds for being satisfied that the Energy Charge has diverged to the required extent from the Comparator is invalid and ineffective.

18. I turn next, therefore, to the meaning of the Comparator. Mr. Howard submitted that the expression used in clause 12.6, namely, "*the market price . . . . . for natural gas being supplied on the basis described above*" (i.e. between parties of similar standing under a long term contract on similar terms and for similar purposes) was intended to refer to the price for gas actually obtainable in the market under a similar long term contract at the date of the Price Review Notice as ascertained by reference to other contracts of a similar kind. This might be called an *'actual'* market price. Mr. Rabinowitz submitted, on the other hand, that the expression was intended to refer to the price at which gas would be supplied under a similar contract negotiated in the market between a willing buyer and a willing seller at the date of the Price Review Notice, if any business of that kind were to be done. This might be called a 'notional' market price.

19. As with any question of construction, the starting point must be the words chosen by the parties themselves to express their intentions, but with due regard to the commercial and contractual context in which they are found. The contract bears all the signs of having been carefully drafted with considerable attention to detail, so I think it is right, as Mr. Howard submitted, to approach it on the assumption that the words used in clause 12.6 were chosen with some care. I accept that the expression "market price" is not a term of art, but it is fair to say that over the course of time it has acquired a reasonably well-recognised meaning as the price at which goods or services of the relevant kind can be bought or sold among a body of willing buyers and willing sellers: see ***The Arpad*** [1934] P. 189 at page 202 per Scrutton L.J., approved in ***Attorney-General of the Republic of Ghana v Texaco Overseas Tankships Ltd (The 'Texaco Melbourne')*** [1994] 1 Lloyd's Rep. 473. Moreover, it is here found in a contract for the sale of goods and in a clause the first sentence of which refers to the "market price" in terms of the price actually obtainable in the market for goods of the kind in question.

20. On the face of it, therefore, there are powerful indications that the parties used the expression "market price" in this case to mean the actual market price as opposed to a notional market price. It was common ground, however, that by November 2002 neither producers nor consumers were interested in entering into long term contracts for the sale and purchase of gas and that there was therefore no active market for the sale of gas on terms comparable to those of the present contract. However, I do not think that that of itself matters, even if it has rendered the machinery temporarily unworkable. What matters for present purposes is whether at the time they entered into the contract the parties contemplated that there would be such a market. The terms of the contract suggest that they did, and indeed Mr. Rabinowitz did not submit otherwise. His case was that the parties could not have intended the price review to be carried out by reference to a Comparator derived from the actual market for long term supplies because that would have been unworkable. They must, therefore, have intended it to be carried out by reference to other material so as to produce a notional rather than an actual market price.

21. Mr. Rabinowitz's argument was based mainly on what he submitted was the practical impossibility of obtaining any reliable information about prices being obtained under other comparable contracts. He drew attention to the fact that the present contract contains a clause which requires the parties to treat its terms and conditions, as well as all information disclosed to each other pursuant to it or in the course of their negotiations, as confidential throughout the period of the contract and for 5 years thereafter. He submitted that a clause of that kind was usually included in such contracts, a view that was supported by the evidence filed on behalf of both Esso and ESB.

22. In the light of that evidence I think one must accept that the parties proceeded on the footing that most, if not all, long term contracts would be likely to contain confidentiality provisions of some kind. No doubt they could be waived on request, if the parties to the contract in question were so inclined, but there is no reason to think that the parties to the present contract made any assumption one way or the other about that. It must also be remembered that the market for the long term supply of gas to power stations was necessarily very small. There were only a few companies willing and able to promise long term non-interruptible supplies and only a few power generators seeking to buy gas on such terms. Mr. Rabinowitz submitted that the parties must have been aware of these matters and must have appreciated that they could not expect to obtain, or, if necessary, place before the arbitrators, sufficient reliable information of prices actually being paid in the market under comparable contracts to enable price reviews to be carried out on that basis.

23. I think it is helpful to begin by considering the fundamental purpose of the price review provisions insofar as that can be discerned from the contract. The price at which gas or any other commodity is sold under a long term contract will reflect many different factors. These will usually include, among other things, the current price for prompt delivery, any price being quoted for delivery at a future date, the parties' perception of the likely movement of prices in the longer term and the particular terms of the contract. In the present case the parties took account of future movements in the price of fuel used for power generation by providing for regular adjustments of the price by reference to the average over the preceding 12 months of the prices of three different fuels for immediate delivery. It is true that the indexation formula was not linked to the price of gas alone and to that extent could not be expected directly to reflect changes in the price of gas, but that was the parties' choice. It seems to me, therefore, that insofar as the parties intended to adjust the price by reference to changes in short term fuel prices, clause 12.2 was the means they chose. What clause 12.2 by its very nature could not achieve,

however, was an adjustment to reflect the other factors that have a bearing on the price payable under a long term contract, such as the value to be attributed to non-interruptibility of supply, to take but one example.

24. The effect of a price review under clause 12.6 is to alter the value of the Energy Charge which forms the basis for the subsequent periodic adjustments under clause 12.2. Accordingly, I think its purpose must have been to reflect changes in the value being attributed to the other factors that influence the price payable under a long term contract, not simply to reflect changes in the spot or short term future price for gas. The extent to which factors of that kind affect the price paid under any given contract must depend to a considerable degree on the particular terms of the contract. It is essential, therefore, that any comparison be based on contracts between similar parties on similar terms, as clause 12.6 requires. However, there remains the problem of how one is to determine the impact of such factors in monetary terms.

25. At this point one comes back to the language of the second sentence of clause 12.6 itself. I think that some significance is to be attached to the fact that it refers not to "the market price *obtainable*" for natural gas supplied on similar terms and under similar circumstances, as the first sentence does, but to "the market price for natural gas *being supplied*" on that basis. Mr. Rabinowitz submitted that those words were used simply to identify the purpose of the Comparator, i.e. to show that it is intended to be the price for gas supplied under a long-term rather than a short-term contract, but in my view the change in language reflects the intention of the parties to direct the reader to the price at which gas is currently being supplied under contracts broadly similar in all respects to the present contract rather than to a notional market price based on the current price for short-term delivery. That in my view is the natural meaning of the words used, but I can see at least two practical reasons why the parties should have looked to similar long-term supply contracts to provide the Comparator. First, because setting a long-term price taking into account all the relevant factors involves a substantial element of commercial judgment; it also depends on the parties' negotiating strengths. Prices set by negotiation in the market place are likely to reflect on average all the factors that have a bearing on the outcome more reliably than the assessment of any arbitrators. Secondly, because, if there really is no market in the long-term sale of gas to power stations, there is no need to re-base the price in order to keep it in line with current market prices under contracts of that kind. If the parties had intended that a new base price should be calculated in any event using whatever information was available, I think that clause 12.6 would have been worded in a way which made that clear. In my view the language used throughout the clause is more consistent with determining the actual price at which gas is being supplied than with calculating a notional market price. For completeness I would only add that I do not think that the second sentence of clause 12.6 limits the parties to contracts made within any particular period prior to the giving of a Price Review Notice. Clause 12.6 defines the Comparator as the market price for natural gas being supplied on the basis described above which will include reasonably similar price review terms. Where gas is currently being supplied under long-term contracts made through the ordinary operation of the market in previous years, the price at which it is currently being supplied may be as relevant as the price payable under a contract negotiated within the last few months.

26. The only question that remains, therefore, is whether the parties cannot have intended to refer to actual market prices because they did not think that it would be possible to obtain sufficient reliable information about the terms on which gas was being supplied. I am not persuaded that that was their view or that as a result they intended to adopt instead a notional market price as the Comparator. Although there is evidence, which I accept, that most long-term sale contracts include confidentiality clauses, there is no concrete evidence that the parties acted on the common assumption that reasonably reliable information about prices currently being charged under long-term contracts would not become available either to them or to arbitrators appointed by them to determine the Comparator. It is interesting to note that paragraph (12) of clause 12.6 allows the arbitrators to rely on all information available to them, not just that provided by the parties. That would entitle them to make use of any knowledge they may have acquired, for example, in the course of their own work. Moreover, if the parties had thought that reasonably reliable information about prices currently being paid under long-term contracts was not likely to be available, I think it most unlikely that they would have left the matter as it stands instead of recognising the difficulty and stating more clearly how the notional market price was to be determined.

27. For these reasons I am satisfied that the Comparator mentioned in clause 12.6 is the actual market price of natural gas currently being supplied under comparable contracts rather than a notional market price derived from the prices for spot or short-term deliveries. It is apparent that in giving its Price Review Notice Esso was proceeding under the mistaken impression that the Comparator was a notional market price and that it was not satisfied, nor, as far as one can tell from the notice, did it have reasonable grounds for being satisfied, that the Energy Charge had diverged to the required extent from the true Comparator. In those circumstances the notice was invalid and no dispute arose that was capable of being referred to arbitration. It follows that the arbitrators lack jurisdiction to make any determination under clause 12.6 and that this application must be dismissed.

Mr. Laurence Rabinowitz Q.C. (instructed by Norton Rose) for the claimant
Mr. Mark Howard Q.C. and Mr. David Quest (instructed by Coudert Brothers) for the defendant