Enforceability of Take-or-Pay Provisions in English Law Contracts – Revisited

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Take-or-pay clauses are commonly found in international energy industry contracts, which are often governed by English law. For the second time in the last five years, the English High Court has raised the concern that a take-or-pay clause may – in principle – be an unenforceable penalty. It is disappointing that a view of such potential significance to the global energy industry has once again been delivered in a very short passage contained in a judgment that does not address the industry's commercial concerns. If take-or-pay clauses may in principle be void as a penalty under English law, this uncertainty is likely to result in unnecessary disputes concerning the enforceability of many such clauses in contracts around the world.

The authors explained the key features of take-or-pay clauses and the English law rule against penalties in an article published in this *Journal* in 2008.[1]

In essence, take-or-pay clauses require a purchaser to pay for a minimum quantity of goods or services, whether or not those goods or services are taken. Take-or-pay clauses are very common in the energy industry, in gas sales contracts, power purchase contracts and other long-term arrangements. As explained in the previous article, sums due under take-or-pay clauses commonly form part of the seller's financing arrangements. Similar send-or-pay provisions are commonly found in energy sector transport contracts.

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1 Ben Holland and Phillip Ashley, 'Enforceability of Take-or-Pay Provisions in English Law Contracts' (2008) 26 JERL 610.

As many international energy contracts are governed by English law, English High Court decisions relating to take-or-pay clauses are of particular importance to the industry.

The rule against penalties is an English law rule that prevents the enforcement of a clause that operates as a penalty against the party in default. The rule against penalties reflects the principle that, in English law, a party is normally free to breach its contractual obligations on payment of damages, the value of which is to be determined by the court applying established principles. A penalty clause operates in a way that attempts to fix a higher measure of damages. As this may have the purpose of deterring a party's freedom to breach its contractual obligations (eg, an attempt to tie in a customer to a hire-purchase contract) such provisions may be considered unenforceable.

Background

In 'Enforceability of Take-or-Pay Provisions in English Law Contracts' the authors responded to Burton J's judgment in *M & J Polymers Ltd v Imerys Minerals Ltd* ('*M & J Polymers Ltd v Imerys*').[2]

In *M & J Polymers Ltd v Imerys*, the English High Court considered the application of the rule against penalties in the context of a take-or-pay clause in a commercial contract. M & J Polymers Ltd ('M & J Polymers') supplied chemical dispersants to Imerys Minerals Ltd ('Imerys') under a long-term supply contract. The contract contained a provision requiring the buyer to order a minimum quantity of chemicals and a take-or-pay clause.

The recitals of the supply contract stated: 'The Buyers want to ensure a regular and reliable supply of the Products and the Supplier agrees to guarantee such supply under the terms and conditions of this Agreement.' The supply contract had a three-year minimum term and contained a take-or-pay clause as follows:

'Article 5: Stock Level and minimum purchase

> 5.3. During the term of this Agreement the Buyer will order the following minimum quantities of Products
>
> …
>
> 5.5 Take-or-pay: the Buyers collectively will pay for the minimum quantities of Products as indicated in this Article at 5.3… even if they together have not ordered the indicated quantities during the relevant monthly period.'

2 [2008] EWHC 344 (Comm).

In the High Court, Burton J was asked, among other things, to resolve whether the sum owing under the take-or-pay clause was unenforceable as it offended the rule against penalties.

M & J Polymers argued that the claim under the take-or-pay provision was a debt and not damages. The distinction is set out in *Chitty on Contracts*:

> 'There is an important distinction between a claim for payment of a debt and a claim for damages for breach of contract. A debt is a definite sum of money fixed by the agreement of the parties as payable by one party in return for the performance of some specified obligation by the other party or upon the occurrence of some specified event or condition; damages may be claimed from a party who has broken his contractual obligation in some way other than failure to pay such debt… The relevance of this distinction is that the rules on damages do not apply to a claim for a debt eg the claimant who claims payment of a debt need not prove anything more than his performance or the occurrence of the event or condition…'[3]

On the basis that the action was for a debt, M & J Polymers referred Burton J to the citation in *Chitty on Contracts* discussing the principle in the House of Lords judgment in *White & Carter (Councils) Ltd v McGregor*[4] that states: 'The law on penalties... is not relevant where the claimant claims an agreed sum (a debt) which is due from the defendant in return for the claimant's performance of his obligations.'[5]

Burton J did not agree with M & J Polymers' arguments and decided that take-or-pay provisions could, in certain circumstances, amount to a penalty clause. The judge decided that:

> 'i) The central dictum of Lord Roskill, in the only speech in the [*Export Credits Guarantee Dept v Universal Oil Products Co*] case, with which the rest of their Lordships agreed is:
>
> > "The clause was not a penalty clause because it provided for payment of money upon the happening of a specified event other than a breach of a contractual duty owed by the contemplated payor to the contemplated payee."
>
> ii) I do not see how a payment obligation can arise under Article 5.5 [the take-or-pay provision] in a case other than where there has been a breach of the obligation to order under Clause 5.3 [the minimum quantity provision]. If the goods are in fact ordered, then they will be delivered, and the price will be due quite irrespective of Article 5.3 or 5.5.

3 *Chitty on Contracts* (31st edn, 2012), vol 1 at para 26-008.

4 [1962] AC 413.

5 *Chitty on Contracts* (29th edn, 2004), vol 1 at para 26-118. It is perhaps of interest that the current edition of *Chitty on Contracts* continues to state in the paragraph dealing with the distinction between debt and damages that 'the law on penalties does not apply to the agreed sum', ie a debt (*Chitty on Contracts* (31st edn, 2012), vol 1 at para 26-008).

iii) There may be an option for a claimant to pursue its claim either for damages for breach of Article 5.3 or for the price in respect of Article 5.5, but on the face of it the "specified event" in Article 5.5 is the same event as amounts to a breach of duty under Article 5.3.'[6]

From this analysis Burton J was 'satisfied therefore that, as a matter of principle, the rule against penalties may apply'.[7] However, he found that in this case the take-or-pay provision did not offend the rule against penalties as:

- contractual provisions are rarely struck down as a penalty;
- the take-or-pay provision was commercially justifiable and did not amount to oppression; and
- the take-or-pay provision was negotiated and freely entered into between parties of comparable bargaining power, and did not have the predominant purpose of deterring a breach of contract.

Since the authors' last article, Burton J has handed down a further judgment in *E-Nik Ltd v Department for Communities and Local Government* ('*E-Nik Ltd v Department for Communities*')[8] that confirms his decision in *M & J Polymers Ltd v Imerys.*

What was the most recent case about?

In *E-Nik Ltd v Department for Communities*, E-Nik Ltd (the 'supplier'/'claimant') was an information technology services company that entered into a contract with the Department for Communities and Local Government (the 'authority'/'defendant') to provide consultancy personnel to help with the government's information technology systems (the 'contract').

The term of the contract was two-and-a-half years and the contract had not been drafted by lawyers. The relevant terms of the contract were:

'2. AUTHORITY'S OBLIGATIONS

2.1 The Authority hereby undertakes to purchase minimum of 500 days of Consultancy from the Supplier per year based on project requirement, additional days will be required once the purchased days have been exhausted.

2.2 The Authority shall issue an Assignment Note to requisition Services from the Supplier.

2.3 The Authority shall pay the Supplier fees at the rate of not less than £850 per day but subject to mutually agreed assignment notes for each change request. …

6 [2008] EWHC 344 (Comm) at para 41.
7 [2008] EWHC 344 (Comm) at para 44.
8 [2012] EWHC 3027 (Comm).

> …
>
> 3. SUPPLIER'S OBLIGATIONS
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> …
>
> 3.8 Supplier is obliged to provide concise accounts of resources used on a monthly basis as an excel document which shows work priorities, days used, days remaining and days purchased.'

An issue arose when the defendant failed to use all the '500 days of Consultancy'. The claimant invoiced for the balance of the 500 days. The defendant disputed the invoices issued for those days. Both parties sought summary judgment against the other on the meaning and interpretation of the contract, including:

1. whether the sums allegedly due for unused days were a debt (or damages); and
2. whether the claim for such sums was an unenforceable penalty.

The High Court decided that the sum allegedly due should be characterised as a debt, not damages. It follows that the claimant was entitled to issue an invoice for the balance of the 500 days' services. In reaching this conclusion, Burton J accepted the claimant's argument that it was required to be 'ready, willing and able to provide the 500 days of consultancy per year throughout the period of the Contract'. This was why the claimant had to keep account of and update the defendant about the remaining days. As a consequence, the defendant was receiving a specified obligation for its consideration.

The claimant then relied on the principles above in support of the proposition that the rule against penalties does not apply to a claim for debt (as the High Court had found the claim to be).

The defendant, however, relied on Burton J's decision in *M & J Polymers Ltd v Imerys*, in which, pursuant to a take-or-pay clause, the High Court concluded that in principle a take-or-pay clause might qualify as a penalty clause.

Burton J decided that:

> 'Mr Gullick [the defendant's counsel], however, relies upon my decision in *M & J Polymers Ltd v Imerys Minerals Ltd* [2008] 1 AER (Comm) 893, in which, notwithstanding that the claim in that case, pursuant to a "take or pay" clause whereby the purchasers agreed to pay for minimum quantities of products even if not ordered, was a claim in debt, I concluded that in principle a take or pay clause might qualify as a penalty clause, but that there was in that case plainly commercial justification for it, that the court should not be "astute to descry a penalty clause" and I was satisfied that it was not a penalty clause. I am entirely satisfied that in the context where, as appears in paragraph 21

> above, the Claimant had to, and did, keep available the wherewithal to provide the consultancy services as called off throughout the entire term, at rates which… were at or below the rates regularly charged by the Claimant to the Defendant, these clauses (to adopt paragraph 46 of *M & J Polymers*) were commercially justifiable, did not amount to oppression, were negotiated and freely entered into between parties of comparable bargaining power and did not amount to a provision *in terrorem*. The Defendant has not produced any evidence to support a converse proposition.'[9]

It follows that Burton J decided that (i) the take-or-pay clause in the contract could in principle be an unenforceable penalty (although he did not expand on reasons), but (ii) in this case, the clause was commercially justifiable and not a penalty on the facts.

Why is this case important?

As with *M & J Polymers Ltd v Imerys*, two aspects of the judgment are of interest to energy companies, service companies in the energy sector, investors and the lawyers that advise them. The first is that the rule on penalties is said to apply to sums arising from take-or-pay clauses. The second is the factors taken into account in deciding that the take-or-pay clause in question was not a penalty.

Take-or-pay provisions – susceptible to the rule on penalties?

The reasoning of Burton J relating to whether the clause in *E-Nik Ltd v Department for Communities* is a penalty is contained within one paragraph of the judgment.[10] However, the analysis appears to build on the decision in *M & J Polymers Ltd v Imerys*.

In *E-Nik Ltd v Department for Communities* Burton J suggests that in *M & J Polymers Ltd v Imerys* he decided that the sum due was a debt and not damages, which is not obvious from that decision. A plain reading of Burton J's reasons suggests that he categorised the claim as a damages claim and it is for this reason that the rule on penalties applied.[11]

However, taking the two cases together, it would seem that Burton J held that the rule on penalties applies to debt claims provided that the event that

9 [2012] EWHC 3027 (Comm) at para 25.

10 [2012] EWHC 3027 (Comm) at para 25.

11 The authors' criticism in 'Enforceability of Take-or-Pay Provisions in English Law Contracts' was based on that understanding.

would give rise to a debt claim also 'amounts to a breach of duty' (or where the debt claim arises in parallel to a breach of contractual duty).[12]

In reaching this conclusion Burton J relied on the 'central dictum of Lord Roskill, in the only speech' in *Export Credits Guarantee Dept v Universal Oil Products Co* that: 'The clause was not a penalty clause because it provided for payment of money upon the happening of a specified event other than a breach of a contractual duty owed by the contemplated payor to the contemplated payee.'[13] Burton J's reasoning in *M & J Polymers Ltd v Imerys* appears to read into this passage that the words 'other than a breach' mean that if a sum is due as a debt arising out of a specified event that is also a breach of duty then the rule on penalties applies.

In *E-Nik Ltd v Department for Communities* Burton J again suggested that a breach of contract may have taken place and referred to 'the repudiatory failure by the Defendant to call off/request the minimum 500 days' services',[14] suggesting that the failure by the buyer to order the product or services is a parallel breach of contract (allowing a claim in damages).[15] It is perhaps for this reason that Burton J again held that the rule on penalties applied.

This analysis is surprising for two reasons. First, *E-Nik Ltd v Department for Communities* and *M & J Polymers Ltd v Imerys* are based on a misreading of Lord Roskill's speech in *Export Credits Guarantee Dept v Universal Oil Products Co*. Secondly, *E-Nik Ltd v Department for Communities* seems to go further than *M & J Polymers Ltd v Imerys* to extend the rule on penalties to any debt claim where a parallel breach of contract has occurred.

12 In *Cavendish Square Holdings BV and Another v Talal El Makdessi* [2012] EWHC 3582 (Comm), Burton J subsequently confirmed that this was his approach (see paras 27 to 29 of the judgment). In that case, Burton J states that one 'development [in the law on penalties], to which I referred, was to expand its operation, although in the event unsuccessfully, into what was otherwise a claim in debt'. In making this statement, Burton J relies on his own judgment in *M & J Polymers Ltd v Imerys* and a short passage in the first-instance decision of Colman J in *Lordsvale Finance Plc v Bank of Zambia* [1996] QB 752, which related to a default interest provision in a loan agreement that had the impact of increasing the interest rate if the borrower was in default. In *Lordsvale Finance Plc v Bank of Zambia* Colman J stated: 'There would therefore seem to be no reason in principle why a contractual provision the effect of which was to increase the consideration payable under an executory contract upon the happening of a default should be struck down as a penalty if the increase could in the circumstances be explained as commercially justifiable, provided always that its dominant purpose was not to deter the other party from breach.' It is unclear from Colman J's judgment whether the additional default interest in that case was ultimately treated by the court as consideration (primary obligation) or liquidated damages (secondary obligation).

13 [1983] 1 WLR 399 at 402H.

14 [2012] EWHC 3027 (Comm) at para 22.

15 If the sum is due on the seller's performance of the 'specified obligation' to be 'ready, willing and able' to provide the service, the primary obligations of the seller to provide those services and the buyer to pay for those services logically arise independently, but perhaps in parallel, with any primary obligation by the buyer to order those services and/or any secondary obligation to pay damages for a failure to do so. It is therefore not possible to classify them as the same 'event'.

Export Credits Guarantee Dept v Universal Oil Products Co

The facts of *Export Credits Guarantee Dept v Universal Oil Products Co* were complex. The case related to a sum due triggered by a breach of a different contract by a third party. The words 'other than a breach' used by Lord Roskill must be seen in the context of those facts. It is likely that Lord Roskill was using the words 'other than a breach' to differentiate between an action for debt and an action for damages – rather than trying to make any point about debt claims that are triggered by an event that is also a breach of contractual duty (or parallel breach).

The text quoted by Burton J from Lord Roskill's speech is, in fact, Lord Roskill's summary of Slade LJ's judgment in the Court of Appeal, not Lord Roskill's statement of the law. Slade LJ's Court of Appeal judgment, in turn, relied on Diplock LJ's judgment in the Court of Appeal in *Philip Bernstein (Successors) Ltd v Lydiate Textiles Ltd*.[16] In that case Diplock LJ explained that the court regarded the 'penalty area' as restricted to the 'narrow field' where there has been 'a prior agreement by the parties to the contract as to an amount to be paid by a party in breach to the other party *in respect of that breach*' [emphasis added].[17] It seems likely, therefore, that Diplock LJ was expressly confirming that the rule on penalties did not apply to debt claims – just sums payable in *respect* of a breach (ie, damages).

Lord Roskill in *Export Credits Guarantee Dept v Universal Oil Products Co* confirmed that the passages from *Philip Bernstein (Successors) Ltd v Lydiate Textiles Ltd* quoted by Slade LJ in the Court of Appeal 'show that the view then taken by the Court of Appeal is in entire conformity with the view of the law which I understand all your Lordships to take and which I have endeavoured to express without reference to that unreported decision'.[18] In other words, Lord Roskill endorsed the reasoning in *Philip Bernstein (Successors) Ltd v Lydiate Textiles Ltd* that the rule on penalties applied to 'a prior agreement by the parties to the contract as to an amount to be paid by a party in breach to the other party in respect of that breach'.

Debt versus damages distinction: further case law

A claim for a debt and a claim for damages are entirely different causes of action. Complications may arise where a sum is stipulated in a contract as payable on a specified event that also amounts to a breach of contract. If this

16 (1962) unreported.

17 (1962) unreported, quoted by Slade LJ in *Export Credits Guarantee Dept v Universal Oil Products Co* [1983] 1 Lloyd's Rep 448 at 439.

18 [1983] 1 WLR 399 at 404B.

occurs, it is a question of construction and interpretation of the agreement whether the sum is a debt or damages for breach of contractual duty.

In answering whether a clause creates a debt or damages obligation, English law will look to the substance of the provisions and not the form. As Bingham LJ explained in *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd*, the law will not allow a party to avoid the rule against penalties by 'disguising' a penalty clause.[19]

If this approach is applied, the issue of penalties should not arise in the context of most take-or-pay or send-or-pay provisions. The House of Lords has twice considered send-or-pay provisions, which are in all essential respects analogous to take-or-pay provisions, and no issue was raised as to these provisions acting as a penalty.[20] In *Amoco (UK) Exploration Company v Teesside Gas Transportation Limited and Another* Lord Hoffmann was satisfied that such payments were an 'income stream' forming 'part of [the sellers'] financing arrangements', under which the sellers' project finance lending was to be repaid. Lord Hoffmann's reference to 'income stream' reflects the fact that they are a debt.

There is therefore no conflict between Lord Roskill's speech in *Export Credits Guarantee Dept v Universal Oil Products Co* and the other authorities, which make clear that the rule on penalties does not apply to debts.

English law authority that such a debt claim is not subject to the rule on penalties can also be found, for example, in the House of Lords decision in *White & Carter (Councils) Ltd v McGregor*,[21] Collins LJ in the Court of Appeal in *Euro London Appointments v Claessens International*[22] and in the first-instance decision in *The Office of Fair Trading v Abbey National PLC and Others*, where the High Court decided that bank charges were not a penalty, as they were a sum due for services performed and not a payment on breach.[23]

In the recent case of *Associated British Ports v Ferryways and Another*[24] the High Court considered a send-or-pay clause in the context of a minimum

19 [1989] QB 443 at 439G.

20 *Total Gas Marketing Ltd v Arco British Ltd and Others* [1998] 2 Lloyd's Rep 209 and *Amoco (UK) Exploration Company v Teesside Gas Transportation Limited and Another* [2001] UKHL 18.

21 [1962] AC 413.

22 [2006] EWCA 385; [2006] AC 436 at 445: 'The short answer to the client's point on penalty is that the agency was suing for its agreed fee. That cannot be a penalty.'

23 [2008] EWHC 875 (Comm). Although the case proceeded to the Supreme Court on other issues, this finding was not appealed (*Office of Fair Trading v Abbey National PLC and Others* [2009] EWCA Civ 116; [2010] 1 AC 696). Other jurisdictions take a different approach: see the decision of the Australian High Court in *John Andrews & Others v Australia and New Zealand Banking Group Limited* [2012] HCA 30, where the High Court decided that the rule on penalties applied – in principle – to charges by banks for honour, dishonour, non-payment and over limit fees.

24 [2008] EWHC 1265 (Comm).

throughput for the handling charges for loading and unloading trailers and containers at a port. The contract between the port operator and the shipper required at clause 4.3:

> 'If after the end of a Year the total number of Units discharged from and loaded to Services at the Port pursuant to this Agreement is less than the Minimum Throughput for the relevant Year then ABP [the port operator] will be entitled to be paid by Ferryways [the shipper] a sum equal to the amount ABP would have received had the Minimum Throughput been met provided that if the shortfall is less than 10% of the Minimum Throughput for the relevant Year no invoice will be issued therefore and the Minimum Throughput for the following Year will be increased by the amount of such shortfall and provided further that any shortfall which has been carried forward from a previous Year shall be disregarded when calculating whether a shortfall in any Year is less than 10% of the Minimum Throughput.'

The shipper, Ferryways, challenged clause 4.3 as a penalty. In rejecting Ferryways' argument Field J decided:

> 'In my opinion, this construction of the definition of "Unit" does not mean that clause 4.3 is a penalty hanging over Ferryways *in terrorem* to procure obedience to a contractual obligation. Instead, by clause 4.3 Ferryways promises to provide ABP with an annual revenue stream calculated by reference to a fixed number of Units and the contract rate for those units. The obligation on Ferryways under clause 4.3 is therefore not a secondary obligation that is triggered by a breach… , but is itself a primary obligation given in exchange for ABP's promise to provide a new linkspan, and as such cannot be a penalty.'[25]

These decisions illustrate the correct approach to analysing take-or-pay and send-or-pay clauses. The revenue stream created by such a clause is almost always a primary obligation (debt) and not a secondary obligation to pay damages on breach. It follows that, for the reasons set out in 'Enforceability of Take-or-Pay Provisions in English Law Contracts', payment due under a take-or-pay clause will almost always be a debt and the law on penalties should not apply.

Is there a difference between take-or-pay and take-and-pay?

Associated British Ports v Ferryways and Another may be distinguished from the two judgments handed down by Burton J, as it related to a send-*or*-pay clause where a failure to 'send' the minimum quantity was not a breach

25 *Associated British Ports v Ferryways and Another* [2008] EWHC 1265 (Comm) at para 50. Although Ferryways appealed to the Court of Appeal, it did not appeal this section of Field J's judgment.

of contractual duty. While *E-Nik Ltd v Department for Communities* and *M & J Polymers Ltd v Imerys* expressly refer to take-*or*-pay clauses, in fact both clauses considered were arguably take-*and*-pay clauses where a failure to 'take' the minimum quantity was held to be a breach of contractual duty. This is a convenient way to isolate the impact of Burton J's judgments from many take-or-pay and send-or-pay clauses. Provided that the 'take' or 'send' is optional, Burton J's analysis could be distinguished and would not apply.

Despite this distinction, a sum must be due as either a primary obligation (debt) or a secondary obligation (damages). It cannot be due as both. Sums under a take-or-pay (or take-and-pay) clause will usually be due for the performance of a 'specified obligation': to make goods or services available. If the sum is due for performance of a 'specified obligation' the payment of the sum must be a primary obligation (debt) – it does not arise because of the breach. It is immaterial that there is a parallel breach by the paying party. With respect, it follows that the decisions in *E-Nik Ltd v Department for Communities* and *M & J Polymers Ltd v Imerys* cannot be correct. Once the High Court decided that the sum due under the take-or-pay provision was a debt there is overwhelming authority that the rule against penalties should not apply.

In addition, there are good public policy reasons for not subjecting pricing provisions in contracts to a test of whether (or not) the price is reasonable unless the provision, properly construed, is a damages rather than pricing provision.

'Specified event' or 'specified obligation'

In *M & J Polymers Ltd v Imerys* the High Court decided that the payment under the take-or-pay clause was due on a 'specified event' that 'is the same event as amounts to a breach of duty'. It was for this reason that the rule on penalties was said to apply.

However, in finding that the sum due was a debt in *E-Nik Ltd v Department for Communities* the court placed an emphasis on the specified obligation of the claimant in keeping staff 'ready, willing and able to provide the 500 days of consultancy per year throughout the period of the Contract'. This reasoning relied on performance of a 'specified obligation' rather than the happening of a 'specified event'.

Although the cases are similar on the facts, the distinction is important. Burton J's analysis in *E-Nik Ltd v Department for Communities* would seem to extend the application of the rule on penalties beyond that in *M & J Polymers Ltd v Imerys*, where payment under the take-or-pay clause was said to be triggered by the 'specified event' that is also a breach of contractual

duty, to circumstances where a debt arises from performance of a 'specified obligation' and there is a parallel breach of contractual duty to 'take' or order a quantity by the buyer. In the case of a debt due to a seller on the performance of a 'specified obligation', it is much more difficult to understand why a parallel breach by the buyer should entitle the buyer to rely on the rule against penalties.

In the authors' view, the confusion started with *M & J Polymers Ltd v Imerys* in which the High Court mischaracterised the sum as due on the 'specified event' of the buyer's breach. In fact, a more appropriate characterisation would have been that the sum was due on the performance of the seller's 'specified obligation' to make the goods available for delivery. This would avoid any question of payment on a 'specified event' that also amounted to a breach of contract and the approach taken by the court in *Associated British Ports v Ferryways and Another* could be applied.

Take-or-pay provisions – when are they reasonable?

In 'Enforceability of Take-or-Pay Provisions in English Law Contracts' the authors set out the court's approach to assessing whether a payment clause susceptible to the rule on penalties was enforceable. The law remains broadly the same. If the clause is reasonable it will be enforceable.

In assessing reasonableness in *E-Nik Ltd v Department for Communities* the court took into account that the supplier had to keep available the wherewithal to provide the services as required throughout the term of the contract. Sellers in the energy industry will very often have a similar obligation to keep available the supply. In addition, take-or-pay payments are connected to the contract price that the buyer would pay anyway. They are rarely drafted to provide any uplift (damages or penalty) element for the seller. It would therefore be extremely difficult to suggest that a take-or-pay clause in the energy industry is not reasonable and therefore unenforceable.

The most important message based on the findings in the two cases above is that the most common take-or-pay clauses appear very likely to be held to be enforceable. However, this good news is likely to be tainted for sellers by the increased opportunity to bring challenges to such clauses.

Protective steps

It may be advisable for contracts to make clear that the buyer 'may' order quantities of the product, rather than imposing an obligation on the buyer that it 'will' or shall place minimum orders. If the contract states 'may' it should not

be a breach of the contract to fail to order the quantity and Burton J's analysis should not apply. Whether this is possible might depend on the commercial imperatives of the project. However, it might be that this offers an easy solution for drafters in some projects.[26]

In addition, where 'make-up' provisions are included in the same contract as the 'take-or-pay clause', allowing the buyer to take the quantity paid for under a take-or-pay payment at a later date, it might be more difficult to characterise the take-or-pay payment as arising from a 'specified event' that is also a breach of duty. It is likely that the payment will be construed as a payment for performance of the 'specified obligation' of delivery at a later date. However, the reasoning of Burton J in *E-Nik Ltd v Department for Communities* might make this proposition more difficult to sustain.

Conclusion

The High Court's application of the rule on penalties to take-or-pay clauses in *E-Nik Ltd v Department for Communities* and *M & J Polymers Ltd v Imerys* blurs the distinction between debt and damages actions. In the authors' view, the High Court's approach is not correct. The revenue stream created by take-or-pay and send-or-pay clauses is almost always a primary obligation (debt) and not a secondary obligation to pay damages on breach. If a sum is due as a debt, the rule on penalties ought not to apply.

Applying the rule on penalties to debts due for goods or services rendered, as well as damages claims, would appear to be without proper legal foundation, as argued in 'Enforceability of Take-or-Pay Provisions in English Law Contracts'.

In the event of English court proceedings relating to a take-or-pay clause in the energy industry, there would be good arguments that the court should not apply the reasoning in *M & J Polymers Ltd v Imerys* or *E-Nik Ltd v Department for Communities*. However, in the absence of further authority from the Court of Appeal, an arbitral tribunal, seeking to apply English law, might apply the same analysis. Given the regularity with which both English law and international arbitration are selected in energy sector contracts, uncertainty in the approach of English law in the area is a potential concern.[27]

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26 This was the authors' suggestion in the previous article and it is confirmed by *Chitty on Contracts*, which comments on *M & J Polymers Ltd v Imerys* and states: 'It will not be subject to the penalty rules if the buyer is simply obliged to pay for a minimum quantity with an option whether or not to take delivery of the goods' (*Chitty on Contracts* (31st edn, 2012), vol 1 at para 26-184 fn 929).

27 An illustration of the uncertainty created by *M & J Polymers Ltd v Imerys* is that Burton J has since had to address the issues arising from that case in two subsequent cases: *E-Nik Ltd v Department for Communities* and *Cavendish Square Holdings BV and Another v Talal El Makdessi* [2012] EWHC 3582 (Comm).

It may also be possible to distinguish the cases as applicable to their facts. While the cases expressly refer to take-*or*-pay clauses, in fact both clauses considered were arguably take-*and*-pay clauses. In both cases the failure to 'take' was held to be a breach of contractual duty. In another case where a failure to send the minimum quantity was not a breach of contractual duty, the rule on penalties has been found by the High Court not to apply. Provided that the 'take' or 'send' is optional, this is a convenient way to isolate the impact of *E-Nik Ltd v Department for Communities* and *M & J Polymers Ltd v Imerys* from many take-or-pay and send-or-pay clauses.