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Annual review of developments in English oil and gas law

2015

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Introduction

Welcome to the inaugural edition of the CMS Annual Review of English oil and gas law developments.

2014-2015 has been an interesting period of developments in English law which have a direct impact on the oil and gas industry. This year, the CMS oil & gas team has been advising on a range of high-profile transactions and disputes, arising in the context of falling oil prices and general instability in markets across the globe.

This Annual Review has been collated by the CMS oil and gas team to be relevant to you, with direct focus on legal developments impacting companies in the oil and gas industry. We begin with looking at recent judgments concerning joint operating agreements and third party access agreements, including the right of an operator to be paid for costs incurred without consent and the enforceability of forfeiture clauses, before reviewing recent decisions concerning European gas pricing and competition issues and the exercise of contractual termination rights of the type common in oil and gas contracts. We also look at a number of recent cases relating to 'Consequential Loss' clauses, and how English law continues to construe such clauses very narrowly. Finally, we look at a number of recent judgments that are relevant to the prevailing unstable market conditions, including a number of cases relating to M&A negotiations and transactions and the exercise of force majeure rights in hydrocarbons sales agreements.

With *Makdessi* (forfeiture enforceability) currently awaiting judgment in the Supreme Court and *Transocean v Providence* (consequential loss – spread costs) currently on appeal to the Court of Appeal, the English courts continue to dispense cases that are directly relevant to the industry.

CMS has been working in the oil and gas industry for many years and we have built an enviable reputation advising key industry players across the globe, in the good times and in the challenging times. The hallmark of this year has undoubtedly been the instability in the market caused by the oil price, and looking forward to the immediate future challenges remain. We hope this Annual Review will help you navigate those challenges and if you have any queries about it, please do not hesitate to contact us.

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Joint operating agreements and third party access

The last twelve months have seen an interesting series of judgments that may impact joint operating agreements ('**JOAs**'), transportation agreements and processing agreements, including in:

— *Santos Offshore Pty Ltd v Apache Oil Australia Pty Limited* [2015] WASC 242 the Australian courts considered the application of pre-emption and Change in Control provisions in the context of a 'package deal'.

— *BG v Talisman* [2015] EWHC 110 (Comm) the High Court provided some important guidance on participant authorisation and consent as a condition precedent to operator payment.

— *Makdessi v Cavendish Square Holdings B.V.* [2013] EWCA Civ 1539 the Court of Appeal reaffirmed the application of the law of penalties to forfeiture clauses but also highlighted the new approach of English law in enforcing 'commercially justified' clauses.

— *Euroil Ltd v Cameroon Offshore Petroleum Sarl* [2014] EWHC 52 (Comm) the High Court was asked to grant an interim injunction in a case where the non-operator participant in a JOA, not being comfortable with the operator's decisions, wished to communicate with the government regulator directly.

These cases illustrate the courts' approach to issues regularly faced in the oil and gas industry. With *Makdessi v Cavendish Square Holdings B.V.* on appeal to the Supreme Court it seems that the law will continue to develop in this area.

Change in Control clauses and pre-emption rights

Change in Control provisions are found in many JOAs. However, there is little legal authority relating to the operation of such provisions when the deal involves the sale of various interests in different licences or government contracts (being, for the purposes of JOA transfer provisions, a 'package deal').

In *Santos Offshore Pty Ltd v Apache Oil Australia Pty Limited* [2015] WASC 242 the Australian courts recently considered the interpretation and application of pre-emption and Change in Control provisions of a JOA concerning the sale of a company which held various interests in different licences. As the relevant clauses were almost identical to those in the AIPN Model Form JOA, the decision may have wider resonance throughout the oil and gas industry.

Background

In 2010, Santos entered into a JOA with Apache Oil, Apache East Spar and Apache Kersail (together, the '**Apache Parties**') (the '**Spar JOA**') governing their relationship in the Western Australian Petroleum Production Licence WA-4-R. The Apache Parties were subsidiaries of Apache Energy Limited ('**Apache Energy**'), which in turn was part of the Apache Group.

In April 2015, the Apache Group and others entered into a sale and purchase agreement with Viraciti Energy Pty Ltd ('**Viraciti**') (the '**Viraciti SPA**'), pursuant to which Viraciti would acquire, among other things, all of the shares and voting rights in Apache Energy (and in turn, the Apache Parties' participating interests in the Spar JOA).

It was accepted that completion of the Viraciti SPA would result in a Change in Control of the Apache Parties[1]. In these circumstances, the Spar JOA provided a right of pre-emption to the other parties. Therefore, and purportedly in accordance with the provisions of the Spar JOA, each of the Apache Parties issued separate pre-emption notices (the '**Notices**') to Santos (on almost identical terms) advising of the proposed Change in Control and offering to sell the relevant Participating Interests.

Santos argued that the Notices were invalid and sought an order requiring the Apache Parties to reissue valid Notices.

The Notices

Each of the Notices included certain terms and conditions of the Viraciti SPA that the Apache Parties claimed were relevant to the Participating Interests, and which the Apache Parties said were adjusted '*to reflect and replicate the same legal and commercial outcomes for (Santos) in relation to the Participating Interests as the legal and commercial outcomes for Viraciti*.'

[1] The Spar JOA defined a Change in Control as any direct or indirect change in the Control (i.e. the ownership, directly or indirectly or more than 50% of the voting rights) whether through a merger, sale of shares or other equity interests or otherwise.

Specifically, each Notice set out a 'Cash Value' for each Participating Interest, and 12 conditions on which the offer to sell was made. Santos challenged the proposed 'Cash Value', as well as 5 of the conditions, as failing to comply with the requirements of the pre-emption rights provisions of the Spar JOA.

The Spar JOA

The pre-emption rights clauses in the Spar JOA contained terms which were almost identical to those in clause 12.3.C, Optional Alternative #1, of the AIPN Model Form JOA.

Relevant for present purposes, Clause 12.3(C) of the Spar JOA provided that, once the final terms and conditions of a Change in Control have been negotiated, '*the Acquired Party shall disclose the final terms and conditions as are relevant to its Participating Interest…*'. Those familiar with the AIPN Model Form JOA will recognise this language from clause 12.3.C.1 of Optional Alternative #1.

Further, Clause 12.3(F) of the Spar JOA provided that each of the other JOA parties had the right to acquire the Acquired Party's Participating Interest for 'Cash Value' on '*the equivalent terms and conditions set out in the Clause 12.3(C) notice* (i.e. the Notice) *for cash*'. The relevant provision of Optional Alternative #1 in the AIPN Model Form JOA is clause 12.3.C.3, although the AIPN Model uses the term '*final*' instead of '*equivalent*.'

Among other things, the Court was asked to interpret both these clauses.

The Decision

The decision provides some useful insight into the way a court or tribunal might interpret pre-emption rights clauses, and the purpose of such clauses.

Purpose of pre-emption rights regime

In providing some context for its decision, the Supreme Court of Western Australia (a court of first instance) gave an overview of the structure and operation of the rights of pre-emption in the Spar JOA. The judge cited with approval a previous Australian decision, in which the purpose of pre-emption rights was described (*Beaconsfield Gold NL v Allstate Prospecting Pty Ltd* [2006] VSC 320 at (33)):

> 'Given the importance of the identity, financial capacity and reliability of the participants in a joint venture, pre-emptive rights operate to ensure that existing participants are empowered to exclude new participants by purchasing the outgoing participant's interest if they so desire.'

Therefore, the court was cognisant not to restrict the operation of the Clause, or otherwise permit the application of pre-emption rights to be avoided, as this would erode the benefit conferred by the grant of a right of pre-emption. Indeed, the terms considered by the court (separating the assets the subject of pre-emption when the third party transaction involves a package of assets, and ascribing a cash value to those assets when the consideration under the third party transaction is for consideration other than cash) are those which parties to JOAs expressly include to ensure that pre-emption rights cannot be avoided.

Clause 12.3(C) of the Spar JOA (clause 12.3.C.1 of the AIPN Model Form JOA)

When considering the extent of the terms and conditions that were 'relevant' to the Participating Interest, the Court recognised that every term and condition in a Change in Control agreement might be viewed as being 'relevant'. However, the Court limited the scope of the clause, and decided that the 'relevant' terms and conditions must be those that '*bear upon, or operate upon, or are otherwise closely connected or related to, the Participating Interest*'. The Court felt that a wider construction might render the rights of pre-emption more difficult to exercise.

Clause 12.3(F) of the Spar JOA (clause 12.3.C.3 of AIPN Model Form JOA)

Regarding the interpretation of Clause 12.3(F) of the Spar JOA, the Court disagreed with the Apache Parties' argument that '*each other Party shall have a right to acquire the Participating Interest…for the Cash Value on the equivalent terms and conditions set out in the* (Notice) *for cash*' meant that the terms and conditions must produce the same legal and commercial outcome for Santos in relation to the Participating Interests as under the Viraciti SPA. Instead, the Court held that the phrase related solely to the determination of the consideration (i.e. the cash) to be paid for the Participating Interest. In other words, the reference to 'equivalent terms and conditions' (or 'final terms and conditions' in clause 12.3.C.3 of the AIPN Model Form JOA) aims to produce an equivalent cash price for the Participating Interest, rather than some other form of consideration as may have been applied under the Change in Control transaction.

When reaching its conclusion, the court considered it was implicit that the terms of the Change in Control agreement would require some modification to enable those terms to operate in the context of a pre-emption rights regime. However, any modifications were limited to: (1) those required to carve out the Participating Interests from the rest of the interests being sold under the Viraciti SPA; and (2) to clarify that the Participating Interest will be acquired for cash (determined in accordance with the definition of 'Cash Value' in the

Spar JOA[2] rather than some other consideration as may have been contemplated in the Viraciti SPA. The application of the Clause is no wider than this.

Comment

While this was a decision of the Supreme Court of Western Australian concerning a JOA subject to Australian law, the principles of contractual interpretation and construction adopted by the Court were ultimately derived from the well-known English authorities of *Investors Compensation Scheme Ltd v West Bromwich BS* [1997] UKHL 28[3].

Therefore, the reasoning of the Court is likely to be relevant to the interpretation and application of similar clauses under English law. As such, the decision provides useful guidance on the way corresponding provisions in the AIPN Model Form JOA, or any other JOA which contains similar pre-emption rights clauses, might also be interpreted and applied by English Courts and/or arbitral tribunals applying English law.

The case is a reminder to companies preparing pre-emption notices for co-venturers, that where the terms of the JOA require, it is important to include all final terms of the third party transaction that are relevant to the participating interest being sold. In circumstances where the proposed third party transaction is a package deal, or for consideration other than cash, this will not always be straightforward.

The provisions which deal with package or non-cash transfers are included in JOAs to ensure that third party deals cannot be structured in such a way to circumvent pre-emption rights, and they therefore allow modifications to the third party transaction to create a 'pre-emptable' deal. The case appears to confirm however that such modifications are only permitted to the extent required to separate the participating interests from the rest of the interests being sold, and to ascribe a cash value to those participating interests. The provisions are not intended to give sellers a right to further modify the terms on which the pre-emption deal may be completed.

Operator expenditure – authorisation and consent as a condition to payment

Should an operator be paid for incurring expense on behalf of the joint venture without first seeking the authorisation required in the joint venture agreement (i.e. is co-venturer authorisation a condition precedent to payment)?

In *BG v Talisman* [2015] EWHC 110 (Comm) the High Court has provided some important guidance on this issue within the context of the cost-sharing mechanisms in an oil industry agreement, reminding practitioners that 'the answer' depends upon what the parties have agreed. On the facts, the High Court decided that the relevant agreement did not make co-venturer payment conditional upon authorisations required by the contract.

Facts

BG and Talisman entered into a transportation, processing and operating services agreement (the '**TPOSA**') concerning operations on the UK Continental Shelf, whereby Talisman (as operator of the Ross field) would provide certain transportation, treatment, processing, storage and offloading services to the owners of the adjacent Blake field (operated by BG).

According to the terms of the TPOSA, BG was to pay for the services provided through a contribution to Talisman's relevant operating expenditure. The contribution was to be calculated by BG paying the proportion of operating expenditure related to the 'stabilised crude oil' allocated to the Blake Field.

Talisman provided the services under the TPOSA using a floating production, storage and offloading vessel (the '**FPSO**'), which was originally chartered from a third party owner of the FPSO, Bluewater (Floating Production) Limited ('**Bluewater**'), under the terms of a specific agreement (the '**FPSO Agreement**').

[2] The Spar JOA defined Cash Value as the market value (expressed in U.S. dollars) of the Participating Interest subject to the proposed Transfer or Change in Control, based upon an amount in cash a willing buyer would pay a willing seller in an arm's length transaction; provided that, in the case of a Change in Control, the Cash Value shall be computed to yield the transferor the same after-tax cash proceeds that would have been obtained from the merger or stock sale comprising the Change in Control transactions.

[3] Save that it appears the English approach might be moving away from too heavy a reliance on the importance of commercial common sense as an aide to construction and interpretation.

After four years, Talisman took over the operation of the FPSO from Bluewater and replaced the FPSO Agreement with a bareboat charter (the '**Bareboat Charter**').

Talisman sought to change the basis upon which BG was required to pay, so as to charge it for its proportion of operating expenditure related to the 'stabilised crude oil' allocated to the Blake field calculated on the basis of the Bareboat Charter cost rather than the FPSO Agreement.

Clause 6.4 of the TPOSA required as follows (our emphasis):

> '(Talisman) has not…made any changes and shall not agree to any changes: (i) to the contractual payment obligations in the FPSO Agreement which will result in increases to Operating Expenditure; nor (ii) in the terms of the FPSO Agreement which would have an adverse material impact on the Services (under the TPOSA), without obtaining the prior written approval of (BG), such approval not to be unreasonably delayed and/or withheld.'

Having decided that that 'operating expenditure' meant actual expenditure and that the Bareboat Charter could be substituted for the FPSO Agreement, the Court had to decide: (i) whether BG's prior written approval was a condition precedent for the replacement of the FPSO Agreement with the Bareboat Charter (and the associated extra operating costs); and (ii) the effects of a breach of the consent requirement.

Decision

The High Court decided that the requirement for consent in Clause 6.4 did not operate as a condition precedent to the payment of the contribution to operating expenditure. It was a promissory undertaking. Clause 6.4 did not render the unapproved changes to Talisman's contractual payment obligations under the FPSO Agreement ineffective as between Talisman and BG (to the extent that they resulted in any increases to the operating expenditure).

Whether BG's consent was actually sought was a fact disputed between the parties and the Court was not asked to determine that fact (it rather focused on providing answers to an agreed list of questions).

On the wording of Clause 6.4, a failure to seek consent was a breach of contract. The remedy for breach of the obligation to seek consent was damages. The assessment of damages flowing from the breach depended upon whether it would have been reasonable or unreasonable for BG to withhold its approval (owing to the presence of that stipulation within Clause 6.4). If a reasonable ground existed, the damages would be the value of the additional operating expenditure contribution. If no reasonable ground existed, BG's claim would have no value (nominal damages).

The burden of proof in showing that BG's withholding of approval was, or would have been unreasonable rested with Talisman. Talisman's subjective belief was irrelevant. Instead, it was necessary to undertake an objective assessment, on the balance of probabilities, of whether the replacement of the FPSO Agreement with the Bareboat Charter would lead to increased operating expenditure or have a material adverse impact on the services provided under the TPOSA.

Comment

The joint ownership of licences/assets and sharing of infrastructure in the oil and gas industry means that many agreements between oil companies contain provisions for cost sharing, which require consent from co-venturers before incurring additional expenditure. For example, the Oil and Gas UK Model Form JOA and the AIPN Model Form JOA both require approval of budgets, costs and/or contracts by co-venturers.

This judgment of the English High Court is a reminder that contractual terms requiring authorisation for expenditure will not always be construed as being a condition precedent to reimbursement by co-venturers. In ascertaining whether consent or authorisation is a condition precedent to payment, English law will consider the terms of the agreement itself. Each contract must be 'read on their own terms'.

Therefore, whilst consent or authorisation is capable of being a condition precedent in some circumstances, the words of the contractual term in question may mean that a breach of the requirement is not a condition to payment but simply a breach of contract. If so, payment will be due. However, this will be subject to a cross-claim for damages. The quantum of any cross-claim for damages will depend upon whether damage has flowed from such a breach. If consent or authorisation would have been required to be given in any event, it seems likely that no damage will flow and the value of any cross-claim for damages will be zero or nominal.

Forfeiture and Penalties

Model JOAs provided by Oil & Gas UK and AIPN contain forfeiture clauses for participant default (with varying degrees of optionality). Following the Court of Appeal decision in *Jobson v Johnson* [1989] 1 WLR 1026, a forfeiture clause will be unenforceable under English law if it amounts to a penalty. As a consequence, the enforcement of forfeiture clauses in JOAs has been subject to much debate.

The recent decision of the Court of Appeal in *Makdessi v Cavendish Square Holdings B.V.* (2013) EWCA Civ 1539 is the first significant application of *Jobson v Johnson*, since that decision was handed down in 1988. *Makdessi* has reaffirmed the application of the law of penalties to forfeiture clauses but also highlights the new approach of English law in enforcing claims that are 'commercially justified' as not amounting to a penalty. The new approach indicates that the traditional description of a penalty clause as not amounting to a genuine pre-estimate of loss is '*too rigid*'. However, the Supreme Court will be handing down a decision on an appeal soon.

Facts

Makdessi sold part of his shareholding in an advertising and marketing company (the '**Company**') to Cavendish. The share sale agreement (the '**Contract**') contained clauses requiring Makdessi to protect the valuable good will of the Company. This required Makdessi to abide by his fiduciary duties to the Company as Chairman as well as restrictive covenants against competition. If he failed in this regard, he stood to forfeit payments for his shares of c.US$ 44 million ('**Clause 5.1**'), and be required to sell his remaining shares (valued at c.US$ 75 million) at a substantial undervalue 'to effect a decoupling' ('**Clause 5.6**'). During proceedings, Makdessi acknowledged that he had been in breach of his fiduciary duties to the Company. The issue was whether the forfeiture clauses in question were unenforceable on the grounds that they were penalties.

Cavendish argued that a commercial justification could permit the reduced price paid. It claimed that, under the Contract, it would pay the full price for the shares provided that Makdessi abided by the restrictive covenants. If Makdessi failed, he could be required to accept a discount on the sale shares and to sell his remaining shares without the value of the good will he himself was unwilling to protect. The clauses, Cavendish argued, simply reflected what it was prepared to pay and, in the absence of absurdity, the Court should not interfere.

The Decision

Makdessi won and the forfeiture clause was not enforceable. The parties did not dispute that the law of penalties applied to Clause 5.1. In respect of Clause 5.6, the Court of Appeal applied *Jobson v Johnson*, confirming its application to forfeiture clauses.

The traditional approach of the Courts resulted in a dichotomy. It required an identification of the purpose and effect of the clause: if it was to 'frighten' a party into compliance, it was an unenforceable penalty; if it was a 'genuine pre-estimate of loss', it was in principle enforceable.

This traditional dichotomy was too narrow. More recent authorities showed that the courts are: (1) adopting a broader test of whether the clause was extravagant and unconscionable with a predominant function of deterrence; and (2) robustly declining to do so where there was a commercial justification for the clause.

On the facts, the immediacy and disproportionate nature of the remedies available under the Contract were extravagant, going beyond compensation and into the realms of deterrence. The Court rejected the commercial justification put forward by Cavendish: the effect of the clauses meant that Makdessi would forfeit sums in the tens of millions of dollars in circumstances where, at law, Cavendish's loss was nil. The clauses also prescribed a form of double jeopardy because Cavendish had the remedies provided for by the clauses and Makdessi remained liable to the Company.

Comment

This case is now on appeal to the Supreme Court. However, the Court of Appeal judgment signals that the issue of whether a forfeiture clause can amount to a penalty is very much alive and well. The case confirms that the law of penalties applies to forfeiture clauses and, as in this case, it can render such a clause unenforceable.

Within the oil and gas industry, there are different opinions on the strength of the arguments either in favour or against the enforceability of the forfeiture clauses found in JOAs. The arguments regarding the law of penalties in this context are well known. The Court of Appeal in *Makdessi v Cavendish* offers the opportunity to review the arguments in a slightly different light.

There are some similarities between the forfeiture clauses in most oil and gas JOAs and the unenforceable forfeiture clause in the *Makdessi* case:

— *Proportionality*: the fact that a single remedy applies to a range of breaches regardless of actual loss.

— *Difficulties of Calculation*: as in Makdessi, the value of the forfeited interest in a JOA is unknown at the time of drafting and, potentially, the worse the breach of the defaulting party, the lower the value of the asset to be forfeited – this illogicality was felt by the Court in Makdessi to indicate that the clause might be penal.

— *Potential Double Jeopardy in JOAs*: if default and forfeiture occurs, depending on the drafting, the defaulting party may still be liable to pay the sums due.

Nonetheless, there may also be certain distinctions:

— *Operation of Forfeiture*: most oil and gas JOAs include a 'grace period', and so the forfeiture does not operate immediately upon a default.

— *Different 'Phases' of Field Life*: in the oil and gas sector, a Court could reach different conclusions based upon the stage of field development.

— *Commercial Justification*: there is a potential commercial justification for forfeiture under an oil and gas JOA. Amongst other things, it is often said that the purpose of forfeiture in oil and gas JOAs is to protect an innocent party's investment by putting in place a mechanism which would enable the joint venture to survive (*see General Trading v Richmond* (2008) 2 Lloyd's Rep 475 referred to in *Makdessi*).

Whether forfeiture clauses found in JOAs fall foul of the rule against penalties has been a topic of debate amongst oil and gas lawyers for many years, and doubtless will continue to be so for some time.

Speaking to the regulator

In *Euroil Ltd v Cameroon Offshore Petroleum Sarl* [2014] EWHC 52 (Comm) the High Court was asked to grant an interim injunction in a case where the non-operator participant in a JOA, not being comfortable with the operator's decisions, wished to communicate with the government regulator directly. This raises an interesting question about who can speak to the regulator when participants in a JOA disagree.

Facts

EuroOil Limited ('**EuroOil**') and Cameroon Offshore Petroleum SARL ('**CAMOP**') were licensees of the Etinde permit, offshore Cameroon. The JOA between EurOil and CAMOP provided that decisions were to be taken by a management committee consisting of a representative from each party. The Production Sharing Contract ('**PSC**') provided for an operating committee consisting of a representative from the Contractor Group (which EurOil filled as Operator, being responsible for implementing decisions made by the management committee under the JOA) and a representative from the Cameroon State.

EurOil wished to move from the exploration phase of the PSC to the development and exploitation phase, and had prepared the necessary application. CAMOP had reservations about both the plan and EurOil's capability to deliver it, although it agreed at the management committee meeting on 3 January 2014 that the development plan should be submitted to the government. CAMOP wrote to the Cameroon State oil regulator (Societe Nationale des Hydrocarbures ('**SNH**')) on 4 January 2014 expressing its reservations and concerns.

Issues

The JOA contained very similar provisions to the Oil &Gas UK Model Form JOA clause 6.6. Clause 6.6 provides that the Operator shall represent the JOA partners in discussions with governments or third parties in relation to joint operations, with each JOA partner having the unfettered right to deal with the government in relation to its own percentage interest. This is very similar to the AIPN equivalent.

Clause 6.6 also provides that the Operator must provide any material correspondence with governments to the other JOA partners and inform them about any meetings with the government or third parties where material matters are to be discussed. Any JOA partner is entitled to attend such a meeting. The Oil & Gas UK Model Form JOA requires, in addition, any material correspondence with governments to be provided to the other JOA partners in advance and consent from each JOA partner obtained as to the contents of such correspondence.

The JOA had an additional provision that EurOil should lead discussions with the government in any meetings. On that basis, EurOil submitted that CAMOP's communication to SNH was in breach of the JOA and asked the court to prevent CAMOP from further written communications with the authorities, and from speaking at meetings with SNH, whilst it brought arbitral proceedings against CAMOP.

Decision

The Court held that this matter should be decided by the arbitration tribunal and granted the interim injunction in the first hearing on 6 January 2014.

In the return hearing on 14 January 2014 however, the judge set aside the injunction and held that his initial decision to grant the order was incorrect given further evidence relating to previous correspondence between the parties and the government, which proved that this was part of ongoing dialogue between SNH and the parties in relation to joint operations.

Comment

This case grants a rare public insight into what can occur when a JOA relationship breaks down. Approval of an expensive development programme and, the fitness of the Operator, are matters which often provoke significant points of difference between JOA partners, especially in respect of their interface with the relevant government department or national oil company.

It is not clear if the additional wording in the JOA in relation to the operator leading discussions with the government weakened EurOil's case for its right to exclusive representation in discussions with SNH. However, JOA parties would be advised to seek advice in relation to their respective rights and obligations under a JOA before contacting a regulator to express a different view from that agreed in the operating committee or seeking to prevent another participant from doing so.

Natural gas and LNG price reviews and competition

Over the last 12 months, global natural gas markets have continued to be affected by gas price review arbitrations. In addition, the regulators in the European market have focused on strengthening competition and reducing perceived anti-competitive activities in the energy sector.

In March 2015, EU leaders approved the establishment of an 'Energy Union' to promote transparency and compliance with EU laws in relation to commercial gas supply agreements, and also considered whether the European Commission should have a formal role in vetting and overseeing such agreements before they are entered into. On 22 April 2015, the European Commission formally accused Gazprom of artificially partitioning EU markets and charging unfair prices in breach of EU competition rules. As these legal and commercial developments unfold, gas pricing is an issue likely to remain in the spotlight over the next 12 months.

The Gazprom Case

Throughout 2014 and into 2015, the EU has taken a more active stance on gas pricing issues. This is particularly against companies at all levels of the supply chain allegedly charging excessive prices for the supply of gas.

In April 2015, the European Commission issued a 'statement of objections', formally accusing Gazprom of operating a strategy of artificially partitioning EU markets in breach of EU competition rules. Central to that accusation are allegations of an unfair pricing policy implemented by: (1) hindering the resale of gas within the EU through territorial restrictions; (2) charging unfair prices; and (3) imposing unrelated commitments on wholesalers as a condition for gas supplies.

The issues around territorial restrictions, preventing customers from reselling gas across the EU, are well trodden. Much more complex and controversial are the pricing issues, and specifically the use (and alleged abuse) of pricing mechanisms when trading gas within the EU. Key to understanding these issues is the relationship between oil-linked long-term (take-or-pay) agreements and the increasing prevalence of hub-based pricing in the more liquid spot and derivative markets. Add to that the complexities of successfully prosecuting an anti-trust case based on excessive pricing, and one can easily begin to understand why it has taken several years for the Commission to put its charge sheet together.

While the Commission has said that it does not have an issue with the industry practice of pegging gas prices to the oil price, the concern is how Gazprom applies pricing formulas in its contracts. Assessing the prices against different benchmarks, such as Gazprom's costs or the German market, the Commission has concluded that the company is abusing its position in the market by charging excessive prices.

Under EU competition law, pricing by a dominant company can be considered to amount to an abuse where it is 'excessive'. The questions to determine are whether the difference between the costs actually incurred and the price actually charged is excessive, and if it is, 'whether a price has been imposed which is either unfair in itself or when compared to competing products' (Case 27/76, *United Brands*). The fact that the price gives the supplier a high margin is not of itself conclusive. Key to a finding of abuse is whether the pricing behaviour can be said to distort competition in the wider market, and in this case whether it forecloses competition from competing suppliers and prevents or otherwise makes it more difficult for wholesalers to resell gas within the EU. This is likely to mean careful analysis of Gazprom's pricing in the five countries under scrutiny — Bulgaria, Estonia, Latvia, Lithuania and Poland — with prices in Germany, which is seen as the only gas market in Europe that is competitive. It is also looking at prices on international spot markets, which are, in some instances, allegedly 40% cheaper than Gazprom's contract prices.

On 23 July 2015, Gazprom's deputy chairman met the competition commissioner for an informal exchange on Gazprom's preliminary views on the accusations made in the Statement of Objections. It appears Gazprom rejects the charges, in particular with regards to the excess pricing allegations. However, it has indicated willingness to 'settle this case amicably'. Gazprom's deadline to submit a formal response to the Commission's charges is mid-September, so it remains to be seen exactly how the company will respond. However, the Commission's provisional findings against Gazprom are likely to have repercussions and implications on the wider European market, and suppliers of gas into the EU should be carefully analysing how this may impact them and their agreements.

The Future of EU Gas Supply Agreements

The EU seeks to tackle gas pricing issues not only retrospectively by penalising past anti-competitive behaviour and breach of the rules, but also by supporting a framework strategy for ensuring prevention of such behaviour and future compliance of those rules. In March 2015, the EU Council agreed to the establishment of an 'Energy Union' to promote transparency and compliance with EU laws in relation to gas supply agreements. However, the EU Council has yet to provide specific details of the powers of the Energy Union and how it will operate alongside the EU Commission and other EU institutions in regulating and overseeing the functioning of the EU gas market and ensuring the compliance of all gas supply agreements with EU law.

The EU Council's intention is that a legal framework will be created to enable the Energy Union to ensure '*full compliance with EU law of all agreements related to the buying of gas from external suppliers, notably by reinforcing transparency of such agreements and compatibility with EU energy security provisions*'. To this end, EU member states have agreed to coordinate and cooperate with the relevant EU institutions to ensure that the gas supply agreements are in compliance with EU law.

According to an EU Council communique, the Energy Union will work towards '*fully implementing and rigorously enforcing existing energy legislation*'. Once implemented, the Energy Union framework is intended to provide greater transparency in the EU gas market and to regulate the conduct of gas suppliers such that suppliers cannot abuse their market position.

The EU leaders agreed that while greater transparency was necessary, member states would be allowed to maintain the confidentiality of commercially sensitive information in their gas supply agreements. Further, the EU member states agreed to assess '*options for voluntary aggregation mechanisms in full compliance with WTO and EU competition rules*'.

The EU Council also considered a proposal to give the European Commission a central role in vetting and approving gas supply contracts across the EU. The proposal would empower the EU Commission to: (1) oversee commercial gas supply agreements before they are entered into by the parties; and; (2) block any such agreements if it considers the contractual gas price to be unfair or if it determines that any provisions of the agreements contravene EU law. While further detail is emerging on the role of the proposed 'Energy Union', there is, as yet, no formal agreement to empower the EU Commission to vet the gas supply agreements prior to execution.

The implications of the Energy Union for existing and new gas sales agreements remain far from clear. The industry will be watching with keen interest the development of regulation on the oversight and veto rights in respect of gas supply arrangements.

Comment

One challenge for the Energy Union will be that, while the EU continues to pursue its vision of a liberalised and fully functioning energy market, regional disparities in sources of supply and transportation infrastructure means that progress towards transparency and liberalisation continues to move at differing paces across the EU. In the interim, gas supply agreements in parts of the EU where liberalisation is yet to result in a competitive market will continue to be regulated by a mix of the commercial or political power of counterparties, competition investigations from the EU Commission and international gas pricing arbitrations, which have, to date, proven a mixed blessing for many of the companies involved.

A communication from the Commission published earlier this year explained that the proposal for vetting gas supply agreements before they are entered into would function to target companies importing gas into the EU and 'effectively avoid undue pressure and ensure respect of European rules'. In other words, it would seek to, for example, pre-empt and avoid the kind of anti-competitive behaviour of which Gazprom is accused. Whether the EU will go as far as to implement such proposals remains to be seen.

For further information on gas price reviews, please ask for our gas price review brochure 'Price Reviews: Results through experience'.

Supply chain LOGIC: option wells

LOGIC agreements continue to be a popular and widely used option for the Oil and Gas industry. There have been a number of cases this past year clarifying the legal position of parties to a LOGIC contract. In one of these cases, *Awilco Drilling Plc v AGR Well Management Ltd* [2014] EWHC 2157 (Comm), the Commercial Court decided that the notification of an 'option well' under the special conditions to a LOGIC Mobile Drilling Rig Contract likely required the company to specify the location of the option well to be drilled. Once this was done, the company (charterer) will likely be irrevocably bound to use the rig at the agreed rates at the location specified in the notification of the option. Additional side-tracks agreed outside the scope of work of wells to be drilled prior to the option well in the drilling program, absent express agreement, would not alter the obligations created by the exercise of the option.

Whilst the court's decision is largely unsurprising, it is helpful reminder of parties' contractual obligations relating to option wells.

Facts

On 14 March 2011, Awilco Drilling plc ('**Awilco**') and AGR Well Management Limited ('**AGR**') entered into a contract for the provision of a drilling unit, the WilPhoenix. Under the contract, one firm well was to be drilled, and AGR had an option for up to six further wells. The option was exercisable at AGR's 'sole discretion'.

The contract incorporated the standard oil industry terms, which included a provision for scope of work:

'The duration of this CONTRACT shall be the time required to drill:

(a) One (1) firm well in Block 206/5a-c in UKCS waters West of Shetland; and

(b) Up to six (6) options wells in UKCS waters;

Up to and including the date and time at which COMPANY'S well operations have been completed.

The foregoing option wells shall be at COMPANY's sole election, and each option well shall be declared on or before sixty (60) days prior to the spud of each option, unless agreed otherwise between the Parties.

Furthermore, COMPANY shall have the opportunity to declare further option wells subject to mutual agreement between the Parties, by giving CONTRACTOR notification sixty (60) days prior to the spud of each option, unless agreed otherwise between the Parties.'

The exercise of the option required AGR to specify the location of the option wells.

In addition to the firm well, AGR notified three option wells. The second and third option wells were to be drilled by AGR for its customer Antrim Energy Inc ('**Antrim**') at Erne and Carra. Around October and November 2011 Awilco, AGR and Antrim commenced steps to prepare for the move of the drilling unit from Erne to Carra – including, signing an emergency response interface document, a management interface document, and an amendment to the rig move procedure.

On 29 November 2011, AGR learned that Antrim may wish to carry out a geological side-track at Erne. AGR took the view that such geological side-track would be outside the scope of work, but it was open to Awilco to agree to undertake such side-track. As the drilling unit did not have follow-on work after Carra, Awilco agreed to carry out the side-track at a reduced daily rate.

After the drilling of the side-track, AGR informed Awilco that the drilling unit was no longer required. Awilco claimed that AGR had exercised an option to drill a fourth well at Carra and its refusal to proceed was a breach of contract.

The essence of Awilco's argument was that an option, once exercised, was irrevocable and gave rise to an enforceable contractual obligation to drill in the location specified and extend the contractual term until that drilling was complete. AGR contended that the options declared were not limited to particular locations and that, consequently, the Erne side-track constituted the fourth well per the declared option so that there was no further obligation to drill at Carra.

Decision

Awilco sought summary judgment that AGR was in breach of contract. Whilst the court decided that the issue should go to full trial and refused to grant summary judgment it did make some interesting comments:

— It considered that Awilco's argument was strongly arguable.

— A sensible, fair and commercial reading of the contract is that the company (charterer) must specify a location in respect of each of the option wells for there to be a finally effective exercise of the option.

— Once this is done, an irrevocable option will have been exercised binding the charterer to using the rig at the rate agreed at the particular locations notified.

— This makes commercial sense, as for the contract to work in a sensible and commercial way, the owner of the drilling unit needs to know the intended location of the option wells, so that preparatory steps can be taken to ensure the efficient deployment of the drilling unit.

Although the court refused to grant summary judgment and gave AGR permission to defend at trial, it considered Awilco's arguments sufficiently strong as to require AGR to pay US$2 million security into court if it wished to proceed with its defence.

Comment

As any agreement to charter a drilling unit is a significant financial commitment and market rates for drilling units can change substantially over time, the exercise of options can have a significant financial consequence.

When using standard term contracts, parties should carefully consider the relationship between the special terms and the general conditions. In many cases, where parties agree to include an 'option' that may be taken up by one party, absent express words to the contrary, that 'option', once exercised, may become irrevocable.

Oil and gas insolvency

Following OPEC's publication of its World Oil Outlook on 6 November 2014, and the continued fall in oil prices since mid-2014, it is apparent that there will be a number of legal pressure points in the next 12 months. This is reinforced by the reported pressures on independent producers in a number of jurisdictions, including on the UKCS. These pressures will increase further if, as Barclays have suggested, US prices will languish around US$50 a barrel through 2016 and beyond. Whilst Goldman Sachs even forecasted crude oil prices to fall over time and reach around US$55 a barrel in 2020, the market decided not to wait that long.

It is important for industry participants and other stakeholders to have legal strategies in place to deal with resulting marketplace changes. This year, CMS has been advising in a number of high profile distressed situations and disputes triggered by falling oil prices and instability in the market. As highlighted in the Financial Times[1], the UK, Angola and Brazil are particularly vulnerable to price movements and CMS is advising in all of these locations, including from Brazil where the office recently celebrated its fifth anniversary. In this market, managing solvency risks is important. The following should be kept in mind.

Establishing a Contractual Relationship

It may be possible to commence legal proceedings if a counterparty to a contract does not perform its obligations under that contract. However, unless there is a specified contractual security, judgment debt ranks a successful party alongside other unsecured creditors in winding up proceedings, so the amount recoverable may be limited in this way. Therefore, when negotiating a new contract, a company can mitigate its exposure to the credit risk of a financially weak counterparty by seeking the following:

- Cash up front.
- A parent company guarantee (relevant if the counterparty is weak due to being an SPV or subsidiary).
- A bank guarantee or letter of credit.
- A lien over goods or retention of title.
- A contractual right to suspend performance if payment is not made by a certain date – there is no equivalent common law right (although there may be certain regulatory restrictions).
- A contractual right to terminate upon insolvency or a credit downgrade.
- If dealing with a JOA, forfeiture upon default with a power of attorney to transfer legal interests (although see *Jobson v Johnson* [1989] 1 W.L.R 1026 and *Makdessi v Cavendish Square Holdings B.V.* [2013] EWCA Civ 1539: a forfeiture clause will be unenforceable under English law if it amounts to a penalty. *Makdessi v Cavendish Square Holdings* is currently on appeal and was heard in the Supreme Court from 21-23 July 2015. Therefore, the law on this area may soon be subject to further developments).

Contract Management – Practical Considerations

If you suspect one of your existing suppliers of assets or services might become insolvent, or equally, if you are a supplier fearing the buyer might become insolvent, CMS suggests the following actions to protect your respective positions:

1. **Check your counterparty's solvency.** Do not assume that the other party to any agreement is solvent. Check online sources (such as Companies House and credit reference agencies) regularly and make searches at court. Ask for any information you are entitled to under your contract.
2. **Have a contingency plan.** Consider how it would impact your business if the counterparty to a supply contract failed to pay or failed to provide an asset or service it was contractually obligated to provide. Consider, in particular, the financial exposure and knock-on effect it might have on your obligations to third parties and your business in general.

[1] Ed Crooks, 'Price of crude oil: how low can it go?', 7 November 2014

3. **Have a strategy for performing the contract.** It is important to have a strategy in place when performing a contract. A good starting point is to ask yourself, 'who needs who more', and use your leverage to strengthen your position. For example, avoid pre-paying for outstanding works, or avoid handing over documents or assets if you are the one who is owed money. Additionally, consider that you may not obtain complete performance from a counterparty, and consider if you can accept that or if any actions need to be taken in this respect.
4. **Think about a default protocol.** Do your teams know what to do if there is a dispute or insolvency? Actions taken (and not taken) in the first few days can be critical to recovery. If you have a protocol, make sure teams understand it; if you do not have one, think about how you could put one in place.
5. **Check your contracts.** Ensure that formal contracts are in place and signed, rather than relying on oral understandings or non-binding heads of terms. Clear written agreements will make it easier for you to enforce your rights. Ensure you apply the terms of that contract so that there is no unintentional waiver of rights.
6. **Arrange a site visit.** If assets are not in your physical control, arrange a site visit to check that they are held in accordance with your agreements.
7. **Understand the risks in your contractual arrangements.** Note for example when title of works pass, when goods are to be handed over, when payment is to be made, what your termination and access rights are, and what kind of security you have. Specifically:
    - With regards to the termination provisions, check when agreements allow you to terminate or remove a party for insolvency, credit rating downgrade or non-payment. Monitor the position and act accordingly.
    - With regards to payment provisions, if title in items you are supplying passes before payment is due, think about how to reduce this risk through L/Cs, parent company guarantees and (where permitted) changes in payment terms.
8. **Do not assume long-term contracts are safer than short term contracts**, as this is not always the case.
9. **Check your approvals.** If incurring expenditure on behalf of others, ensure that relevant approvals are in place, for example: approved work programmes and budgets, authorisation for expenditure and approval of major contracts.
10. **Check the currency of your contracts**, and make sure you are properly hedged against currency movements.
11. **Check your invoicing protocols**. Make sure you are invoicing in accordance with your agreements, providing all necessary supporting documentation, and enforcing payment dates.
12. **Avoid extending any credit or making any prepayment**. Consider any alternatives available to advance payment.
13. **Put pressure on a counterparty to pay**. However, be aware of claw back risks if the counterparty does go insolvent, such as liquidators challenging the payment on the basis that it put you in a better position than other creditors.
14. **Think about timing**. Once a party goes into administration or insolvency, the law applicable to that process may restrict your contractual rights. Ensure that you understand such restrictions and do not delay acting until it is too late.

Termination for breach

The collapse in hydrocarbon prices has resulted in many parties carefully reviewing contractual commitments with a view to termination. Where termination for convenience is not available (or commercially realistic) attention naturally turns to a party's ability to terminate for default.

Two recent cases illustrate how English law's approach to termination for default will largely depend upon the drafting of the termination clause. The cases give an insight into:

1. The seriousness of the breach needed to justify termination where the termination clause requires a default notice and remedy period; and
2. The meaning of remedying a default to the satisfaction of the innocent party, where this is a requirement of the termination clause.

Such provisions are regularly found in oil and gas contracts, and so are of particular relevance to the industry.

Termination after notice not the same as termination for 'any default'

In *Obrascon Huarte Lain SA v Attorney General of Gibraltar* [2014] EWHC 1028 (TCC), the High Court considered a contract containing a notice of default provision that allowed a party to terminate if the other failed to remedy a default notified in a notice of default.

The High Court decided that the existence of default notification followed by a remedy period allowed the Court to apply a lower standard to the severity to breaches needed for termination than if the clause had simply allowed termination for 'any default' without notice. The Court also gave guidance to the parties on when a default notice may properly be issued.

Facts

The case related to a FIDIC Yellow Book contract.[1] Obrascon Huarte Lain SA ('**OHL**'), a substantial Spanish civil engineering contractor, and the Government of Gibraltar ('**GOG**'), had signed a contract for the design and construction of a road and tunnel under the eastern end of the runway of Gibraltar Airport.

After over 2½ years of work on what should have been a 2 year project and when little more than 25% of the work had been done, the contract was terminated. Issues arose as to who was legally and factually responsible.

The termination clause at Clause 15.1 of the General Conditions of Contract required that:

> '15.1 If the Contractor fails to carry out any obligation under the Contract, the Engineer may by notice require the Contractor to make good the failure and to remedy it within a specified reasonable time.
>
> 15.2 The Employer shall be entitled to terminate the Contract if the Contractor:
>
> (a) fails to comply…with a notice under Sub-Clause 15.1…
>
> (b) …plainly demonstrates the intention not to continue performance of his obligations under the Contract,
>
> …
>
> In any of these events or circumstances, the Employer may, upon giving 14 days' notice to the Contractor, terminate the Contract and expel the Contractor from Site.'

OHL argued that 'a contract which contains a provision such as Clause 15.2 which entitles an employer to terminate by reason of a failure to remedy a breach of contract which has been the subject of a Clause 15.1 notice… the breach of contract that is relied upon must be serious and one which is analogous to a repudiatory breach of contract'.

[1] That is, it was based on the FIDIC Conditions of Contract for Plant and Design-build for building and engineering works designed by the Contractor 1ST Edition 1999, with some minor changes

In support of its argument, reference was made to the decision of the House of Lords in *Antaios Compania Naviera SA v Salen Rederierna BA (The Antaios)* [1985] AC 191 where it was held that arbitrators were plainly right to have decided that a clause in a charterparty that provided that the owners were entitled to withdraw 'on any breach' only gave a right to withdraw where there was a repudiatory breach.

A breach will be a repudiatory breach only if it is 'so grave as to go to the root of the contract' and 'deprive(s) the party … of substantially the whole benefit' of the contract. It follows that it will be in relatively rare circumstances that a party commits a repudiatory breach.

The question arose whether the defect notice provision in Clause 15.1, when taken together with the Clause 15.2(a) right to termination, meant that the Court was entitled to apply a different (lower) standard in deciding whether termination was permitted.

Decision

The Court decided that it was entitled to apply a lower standard to the employer's right to terminate for failure to comply with a notice than the repudiatory breach. It further decided that GOG was entitled to terminate the contract.

In upholding GOG's right to terminate, the Court decided a number of points that will be of interest to the oil and gas industry, where similar termination clauses are used in some procurement contracts:

- Each contract should be considered on its own terms. For instance, if the termination clause allowed termination 'for any breach of contract no matter how minor', the meaning is clear and would not require some repudiatory breach.
- The notice provision in Clause 15.1 relates only to more than insignificant contractual failures by the Contractor.
- The specified time for compliance with the Clause 15.1 notice must be reasonable in all the circumstances prevailing at the time of the notice. What is reasonable is fact sensitive.
- Clause 15.1 is designed to give the Contractor an opportunity and a right to correct an identified contractual failure.
- Most of the cases that found that 'any breach' meant any repudiatory breach, did not involve contracts like the contract in this case. The contract in this case gives a list of grounds on which termination can take place that includes one which is not unlike the test for English common law repudiation, namely Clause 15.2 (b) (where the Contractor 'plainly demonstrates the intention not to continue performance of his obligations under the Contract'). The existence of Clause 15.2(b) might be said to indicate that Clause 15.1(a) governs something different to a repudiatory breach.
- The cases relied upon by OHL in this context had a relatively simple right to terminate (for a, or any, breach). The contract here at least for the Clause 15.2(a) basis (failure 'to comply…with a notice under Sub-Clause 15.1') had a warning mechanism whereby termination could be avoided by the contractor's compliance with the Clause 15.1 notice. In that sense, the contractor is given the chance to avoid termination whilst the simple termination for any breach can come out of the blue. Commercial parties would sensibly understand that this contractual chance is a warning as well to the contractor and the remedy is in its hands in that sense.

Comment

This case provides some useful guidance on the drafting and application of termination clauses in the oil and gas industry. The following principles transpire:

General rule

- Each contract and termination clause must be construed on its own terms. It is therefore important to avoid broad generalisations as to the meaning and effect of termination clauses (and contracts) of differing drafting.

Repudiatory breach or lesser default

- Where the contract provides for the innocent party to issue a default notice where 'Contractor fails to carry out any obligation under the Contract', and terminate for failure to remedy the default identified in that notice, English law will likely allow termination for breaches of a lesser severity than repudiatory breaches. In *Obrascon Huarte Lain SA v Attorney General of Gibraltar*, the High Court decided that the contract entitled the employer to issue a default notice provided that the breach was not 'insignificant' or 'trivial'. If the contractor did not then remedy the defect in a reasonable time, the employer was then entitled to terminate the contract.
- It remains to be seen whether other Courts will adopt an analogous approach to all termination clauses that contain notice provisions. It is important to be aware that the relationship between the notice provision, the words of the termination clause and the parties' respective rights upon termination might have a material impact the scope of the termination right. In this respect, the LOGIC model form contracts differ to the FIDIC Yellow Book (as in *Obrascon Huarte Lain SA v Attorney General of Gibraltar*) in that they require the company to issue a notice of default in advance of terminating for 'any breach'. In this context, it remains to be seen if similar reasoning applies to LOGIC contracts.

LOGIC Contracts – remedying default to the innocent party's satisfaction

The High Court's decision in *Bluewater Energy Services BV v Mercon Steel Structures BV* [2014] EWHC 2132 (TCC) will be closely followed by the users of LOGIC contracts. In this case the High Court decided the standard to be applied to a contractor's obligation, upon notice, to remedy a defect to the 'satisfaction of' the company/employer or risk termination by the company/employer.

The High Court decided that the company/employer was largely entitled to take a subjective view of what it considered satisfactory. English law did not require the Court to carry out an 'after the event' review of the company/employer's decision based on an objective standard of reasonableness. However, the company/employer must act honestly, in good faith and genuinely. An arbitrary, capricious, perverse or irrational decision by the company/employer would amount to a breach of contract.

Facts

Bluewater entered into a sub-contract with Mercon for the fabrication of a tower based soft yoke system ('**SYMS**') for installation as part of the development of the Yuri Korchagain Field in the Caspian Sea.

The termination provisions of the sub-contract followed those found in certain of the LOGIC model form contracts and stated:

> '30.1 BLUEWATER shall have the right by giving notice to terminate all or any part of the WORK or the CONTRACT at such time or times as BLUEWATER may consider necessary for any or all of the following issues:
>
> (a) To suit the convenience of BLUEWATER; or
>
> (b) Subject only to Clause 30.2 in the event of any default on the part of the CONTRACTOR
>
> 30.2 In the event of a default on the part of the CONTACTOR and before the issue by BLUEWATER of an order of termination of all or any part of the WORK of the CONTRACT, BLUEWATER shall give notice of default to the CONTRACTOR giving the details of such default. If the CONTRACTOR upon receipt of such notice does not immediately commence and thereafter continuously proceed with action satisfactory to BLUEWATER to remedy such default BLUEWATER may issue a notice of termination in accordance with the provisions of Clause 30.1.'

Various disputes arose between the parties in relation to alleged defects and delays. On 23 January 2009 Bluewater served a Notice of Default, which was followed by a Notice of Termination on 3 February 2009. Mercon claimed that Bluewater's Notice of Termination amounted to a repudiatory breach of contract.

An issue arose as to the standard to be applied under Clause 30.2 to determine whether or not action taken by Mercon was satisfactory. Bluewater argued that the words 'action satisfactory to BLUEWATER' meant the subjective view taken by Bluewater and there was no objective reasonableness to be imported. It argued that it was not open to the Court to retrospectively superimpose its own view on what Bluewater may or may not have found to be satisfactory.

Mercon argued that Bluewater's actions had to be objectively reasonable, so that it was not a question of the subjective satisfaction of Bluewater. In this regard, Mercon relied upon Clause 33.1 of Section 2 (a) of the sub-contract, which provided:

> 'Both the CONTRACTOR and BLUEWATER shall uphold the highest standards of business ethics in the performance of the CONTRACT. Honesty, fairness and integrity shall be paramount principles in the dealings between the parties.'

It also relied upon an existing Court of Appeal decision of *Socimer International Bank Ltd (in liquidation) v Standard Bank London Ltd* [2008] EWCA Civ 116 to argue that the exercise of contractual discretion should not be abused and must be exercised within boundaries of rationality.

Decision

The High Court decided that Clause 30.2 was not one which is required to be construed by reference to an objective standard. The clause did not permit a review, after the event, of whether the action taken to remedy the defect was or was not objectively satisfactory. However, there was a limitation on the ability of Bluewater to come to a decision on whether the action was satisfactory. That limitation, as expressed in Socimer, is a limitation by reference to concepts of honesty, good faith, and genuineness, and the need for the absence of arbitrariness, capriciousness, perversity and irrationality. The Court did not consider that this limitation depended on the presence of Clause 33.1 of Section 2(a) of the sub-contract. However, it was consistent with the inclusion of such clause.

The question of whether the action taken by Mercon was satisfactory to Bluewater was therefore a matter for the subjective view of Bluewater, subject to the implied limitation summarised in Socimer.

On the facts, Bluewater was able to establish that one, or more, of the grounds relied upon was a situation where Mercon had failed to remedy a defect to its satisfaction, and that it was therefore entitled to terminate.

Comment

The following principles can be drawn from this case:

— The decision of the High Court is a useful reminder that where a contract confers discretion on one party, it will usually be implicit that the discretion must be exercised honestly and rationally and for the purpose for which it was conferred. If the right to terminate requires the company/employer to exercise discretion as to whether defects have been corrected, the High Court has indicated that the principles relating to the exercise of discretion will apply to such clauses as well.

— It follows that in terminating contracts, or exercising other contractual discretion, in the absence of express wording, parties should keep in mind that discretion is likely to be fettered. If a dispute arises, document disclosure will likely be sought of a party's decision making process. As a consequence, board minutes, internal meeting notes, emails etc relating to the reasons for termination will likely become key documents.

— In drafting contracts that contain a discretion conferred upon the company/employer concerning the remedy of defects, parties should consider whether they are content that the implied restriction alluded to in *Bluewater Energy Services BV v Mercon Steel Structures BV* is appropriate, or whether express wording of the same, or a differing, standard should be agreed.

Consequential loss

Consequential Loss exclusion clauses are ubiquitous in the oil and gas industry and the last twelve months has seen a flow of decisions of critical importance to the industry. The decisions have reaffirmed that English law will seek to construe such clauses narrowly, sometimes in ways that might not be expected by all industry participants. The Court of Appeal has also suggested that the existence of such clauses in a contract might impact the prospects of gaining interim injunctive relief to restrain an alleged wrongful termination:

— In New York, *Biotronik A.G. v Conor Medsystems Ireland Ltd., et al.*, 2014 WL 1237514 [N.Y. March 27, 2014] the Courts caused a stir among legal practitioners when it was decided that the lost profits arising from a collateral contract with a third party constituted general (direct) damages and were not exempted by a 'consequential damage' exclusion clause. English law largely reflects the same approach.

— In *Glencore Energy UK v Cirrus Oil Services Ltd* [2014] EWCH 87 (Comm) the High Court considered whether a 'consequential loss' exclusion clause of the type commonly found in the oil and gas industry that sought to exclude liability for loss of expenses and profits extended to excluding damages under Sections 50(2) and (3) of the Sale of Goods Act 1979.

— In *Polypearl Ltd v E.On Energy Solutions Ltd* [2014] EWHC 3045 (QB) the English High Court confirmed that it would construe such a clause in a manner that assumed that a direct loss of profits was not intended to fall within excluded 'consequential loss' unless the clause clearly indicated this was the case.

— In *AB v CD* [2014] EWCA Civ 229 the Court of Appeal considered whether a broad 'consequential loss' exclusion clause (along with a limitation of liability clause) precluded the granting of an interim injunction to restrain a breach of contract in advance of it taking place.

— In *Bluewater Energy Services BV v Mercon Steel Structures BV* [2014] EWHC 2132 (TCC) the High Court expressed some views on whether a LOGIC contract would entitle the innocent party to claim 'loss of profits' in the event that the contract was wrongfully terminated.

— Finally, in *Transocean Drilling UK Ltd v Providence Resources plc* [2014] EWHC 4260 (Comm) the High Court sought to answer two burning questions regularly raised in the context of drilling unit contracts, in deciding that: (1) the rate applicable during periods of breakdown was not payable when the breakdown occurred due to a breach of contract by Contractor; and (2) a consequential loss clause, similar to the form found in many equivalent agreements, did not exclude the Company's right to claim its 'spread costs' against the Contractor during periods of Contractor default.

Consequential Loss: Direct 'Loss of Profits'

A recent decision by the New York Court of Appeals in *Biotronik A.G. v Conor Medsystems Ireland Ltd., et al.*, 2014 WL 1237514 [N.Y. March 27, 2014] caused a stir among legal practitioners in New York. The Court held that the lost profits arising from a collateral contract with a third party constituted general (direct) damages and was not exempted by a 'consequential damage' exclusion clause. Previously, it was widely thought that all loss of profits would be covered by consequential loss exclusions.

In English law, 'loss of profit' has in many circumstances been decided by the courts to be 'direct loss'. However, *Biotronik* remains of wider interest as it highlights cross-jurisdictional differences in contractual interpretation and the importance of carefully drafting 'consequential loss' exclusion clauses.

Although *Biotronik* is not an energy industry case, the issues addressed by the New York courts will be of interest to the energy industry where 'consequential loss' exclusions are commonplace and lawyers involved in transactions come from differing legal traditions.

Consequential loss' in English law

The general rule under English law for the recovery of damages following breach of contract was set down in *Hadley v Baxendale* [1854] EWHC J70: recoverable damages are those either (1) arising naturally or directly from the breach of contract ('direct loss'), or (2) within the contemplation of the parties at the time they made the contract ('indirect' or 'consequential loss'). Other losses are irrecoverable as remote.

The second limb of loss in *Hadley v Baxendale* covers situations where there is 'knowledge of special circumstances' at the time of the contract and a party has therefore been put on notice of a type of 'exceptional loss', which would not arise in the usual course of things, that by reason of that notice it has effectively undertaken to bear in the event of a breach.

Exclusion of 'consequential loss' in English law

In English law, where a contract exempts liability for 'consequential loss', it will normally be interpreted (absent contractual definition) as excepting a party only from such loss as is recoverable under the second limb of the 'rule' in *Hadley v Baxendale* i.e. 'exceptional loss' relating to 'knowledge of special circumstances'.

The English courts have repeatedly made it clear that an exclusion of 'indirect or consequential loss' does not exclude 'loss of profit' that arises directly and naturally from the breach i.e. loss of profits that a reasonable business man would expect to flow from such a breach in the usual course of events. This will often include losses of profit from collateral arrangements with third parties.

However, it is, open for the parties to agree a wider definition of 'consequential loss' if they so elect. For those in the oil and gas industry, this is common practice (see for example: Oil & Gas UK Model Form JOA, AIPN Model Operating Agreement, Crine/LOGIC standard contracts).

The Biotronik Decision

The background to the *Biotronik* dispute concerned a distribution agreement between the parties, under which Biotronik was an exclusive distributor for certain areas of a specialised stent. The dispute arose when Conor Medsystems ceased worldwide distribution causing Biotronik to believe it was entitled to damages for lost profits, despite the contract's provisions excluding 'any indirect, special consequential, incidental or punitive damage'.

It seems that New York case law was understood by many practitioners to have previously decided that 'lost profits' were 'consequential damages' when, as a result of the breach, loss is suffered on collateral business relationships. However, in *Biotronik* the New York Court of Appeals reached a different conclusion.

The agreement in *Biotronik* contemplated the re-sale of the stents and the contractual price was benchmarked against the re-sale price. On this basis, the contemplation of collateral relationships was found to be the very essence of the contract. The Court held that this meant that lost profits were the 'direct and probable result of a breach and thus constitute general damage'. As general damage, the losses could be claimed by Biotronik because they were not excluded by the exemption clause.

Comment

Unlike in New York law, there has been no tendency under English law to label 'lost profits' arising from the existence of relationships with third parties as consequential or indirect damages.

In many cases, in English law, loss of profits under collateral or on-sale arrangements will be deemed to be naturally flowing from the breach and likely to be direct loss. It will only be where the loss is 'exceptional', and arises from special circumstances, that the loss is likely to be defined as 'consequential loss'.

However, the law on this subject remains in transition. Before placing reliance on the 'rule' in *Hadley v Baxendale* to define the meaning of 'consequential loss' or on the common law rules on remoteness of damages to limit recoverability, parties should keep in mind the advice of the retired Law Lord, Lord Hoffmann, that: 'For my own part I think that, although an excellent attempt was made in *Hadley v Baxendale* to lay down a rule on the subject (i.e. recoverable damages), it will be found that the rule is not capable of meeting all cases; and when the matter comes to be further considered, it will probably turn out that there is no such thing as a rule, as to the legal measure of damages applicable in all cases'.

It therefore remains important, in sophisticated contractual relationships, that the parties clearly express their intention as to the scope of recoverable loss and exclusions of liability in the contract.

Consequential loss: Excluding 'Loss of Profits'

In *Glencore Energy UK v Cirrus Oil Services Ltd* [2014] EWHC 87 (Comm) the High Court recently considered whether a 'consequential loss' exclusion clause of the type commonly found in the oil and gas industry that sought to exclude liability for loss of expenses and profits extended to excluding damages under Sections 50(2) and (3) of the Sale of Goods Act 1979 (the '**Act**'). Interestingly, the High Court decided that the exclusion clause did not prevent the claimant from claiming damages under the Act.

Background

The case considered a contract for the sale and purchase of crude oil from the Ebok field in Nigeria between Glencore Energy UK Ltd ('**Glencore**') and Cirrus Oil Services Ltd ('**Cirrus**') (the '**Sales Contract**') and a subsequent claim brought by Glencore against Cirrus for repudiation of the Sales Contract.

Under the Sales Contract, Glencore agreed to sell crude oil to Cirrus, which it had in turn agreed to purchase under another contract from its supplier, Socar Trading SA ('**Socar**'). After the Sales Contract had been entered into, Cirrus refused to proceed with the purchase of crude oil after learning that the product was blended. Glencore accepted that Cirrus had repudiated the Sales Contract and subsequently terminated its contract with Socar since it could longer sell the crude oil to Cirrus. Glencore then brought a claim against Cirrus for non-acceptance under Sections 50(2) and (3) of the Act.

Section 50(1) of the Act states that where a buyer wrongfully neglects or refuses to accept and pay for goods, the seller may maintain an action against him for damages for non-acceptance. Section 50(2) of the Act states that 'the measure of damages is the estimated loss directly and naturally resulting, in the ordinary course of events, from the buyer's breach of contract' and Section 50(3) of the Act states that 'where there is an available market for the goods in question, the measure of damages is prima facie to be ascertained by the difference between the contract price and the market or current price at the time or times when the goods ought to have been accepted or (if no time was fixed for acceptance) at the time of the refusal to accept'.

Cirrus argued that Glencore's claim under Sections 50(2) and (3) of the Act was simply a claim for loss of profit that Glencore would have earned had the transaction been completed. Cirrus stated that all liability for such loss of anticipated profits was excluded by the relevant exclusion clause, regardless of whether or not such losses were seen to be indirect or consequential losses or expenses.

Exclusion Clause

The Sales Contract incorporated Section 32 of the BP General Terms and Conditions for the Sale and Purchase of Crude Oil by reference which stated:

> 'Except as specifically provided in the Special Provisions or in Section 12.4, in no event, including the negligent act or omission on its part, shall either party be liable to the other, whether under the Agreement or otherwise in connection with it, in contract, tort, breach of statutory duty or otherwise, in respect of any indirect or consequential losses or expenses including (without limitation) if and to the extent that they might otherwise not constitute indirect or consequential losses or expenses, loss of anticipated profits, plant shut-down or reduced production, loss of power generation, black outs, or electrical shutdown or reduction, hedging or other derivative losses, goodwill, use, market reputation, business receipts or contracts or commercial opportunities, whether or not foreseeable'.

Decision

The High Court did not accept Cirrus's submissions and held that Glencore could recover damages from Cirrus. The High Court held that the difference between the contract price and the market price was not a computation of lost profit and that the measure of damage constituted by Section 50(2) and (3) of the Act was designed to compensate the seller for loss of bargain by calculating the situation that the seller would be in if he sold the goods in question to a substitute buyer at the time of the breach. Since this calculation was not a calculation of lost profits, the exclusion clause did not operate to exclude Glencore's claim. The High Court further held that if Cirrus's statements were correct then Glencore would not be entitled to recover any sums of money from Cirrus since it suffered no losses itself in terminating its contract with Socar. Such an outcome would require very clear words, which were not found within the wording of the Sales Contract.

Comment

This case provides yet another example of the need to draft clauses which exclude certain heads of loss within a consequential and indirect loss exclusion clause very clearly. The Courts construe exclusion clauses strictly and absent express wording to exclude a particular type of loss, the Courts will be slow to give an expansive interpretation to an exclusion in a contract. If the parties intend to exclude claims for a specific type of loss then this should be very clearly stated within such a clause.

Consequential loss – Another parenthetical profits dilemma

In yet another 'consequential loss clause' case that will be of interest to the oil and gas industry, the English High Court confirmed in *Polypearl Ltd v E.On Energy Solutions Ltd* [2014] EWHC 3045 (QB) that it would construe such a clause in a manner that assumed that a direct loss of profits was not intended to fall within excluded 'consequential loss' unless the clause clearly indicated this was the case.

As a result, the words 'Neither party will be liable to the other for any indirect or consequential loss, (both of which include, without limitation, pure economic loss, loss of profit, loss of business, depletion of goodwill and like loss)' were insufficient to exclude a claim for loss of profit directly following from the breach.

Background

In May 2011, Polypearl Limited ('**Claimant**') and E.ON Energy Solutions Limited ('**Defendant**') entered into two written agreements, a Master Agreement ('**Master Agreement**') containing general terms and conditions for the supply of certain cavity wall insulation products (the '**Products**'); and an Insulation Scheme Event Transaction Document ('**ISETD**').

The Defendant argued that it was not obliged to purchase a set quantity of products under the ISETD and denied that it was in breach of its terms. The Defendant also submitted that, if it was required to purchase that set quantity, the Claimant's losses were excluded under the Master Agreement, as a loss of profits.

The wording of the relevant exclusion clauses in the Master Agreement stated:

> (10.1) 'Neither party will be liable to the other for any indirect or consequential loss, (both of which include, without limitation, pure economic loss, loss of profit, loss of business, depletion of goodwill and like loss) howsoever caused (including as a result of negligence) under this Agreement, except in so far as it relates to personal injury or death caused by negligence'.

Decision

The Court considered that the wording of Clause 10.1 of the Master Agreement in parenthesis was ambiguous since it was not clear whether the wording in parenthesis meant that all loss of profits claims were excluded (whether or not such losses were indirect losses), or whether the wording in parenthesis referred to indirect loss of profits claims only.

However, the Court decided that the words in parenthesis were subordinate to the phrase 'indirect or consequential loss' and were not an attempt to place a direct loss in the indirect category since it was very unlikely that businessmen would intend to exclude liability for direct loss and the clause must therefore be construed in accordance with common business sense. Clear words would be required if the parties intended to abandon remedies for all losses (and therefore for any breach of the agreement), and the clause did not clearly indicate this.

The Claimant's losses of profits were held to be direct losses since such losses were the most obvious losses arising from the Defendant's breach.

Comment

The Courts construe exclusion clauses strictly and absent express wording to exclude a particular type of loss, the Courts will be slow to give an expansive interpretation to an exclusion clause in a contract and will not deem a claim for direct loss of profits to be a claim for indirect loss of profits, unless express wording is included. The case provides further illustration that if the parties intend to exclude claims for a specific type of loss, then this should be very clearly stated within such a clause.

Aficionados of 'consequential loss clause' debates will recognise that a similar parenthetical dilemma was resolved in the same manner by the High Court in *Markerstudy Insurance Co v Endsleigh Insurance Services* [2010] EWHC 281 (Comm).

Interestingly, and as referred to at pages 25 and 26, in *Glencore Energy UK Ltd v Cirrus Oil Services Ltd* [2014] EWHC 87 (Comm) the High Court also recently decided that losses relating to a failure to take delivery of crude under Section 50 of the Sale of Goods Act, were not a 'loss of profits' that could be captured by a widely drafted exclusion clause that expressly excluded direct loss of profit.

‘Consequential loss’ Impact on injunctive relief

In the recent case *AB v CD* [2014] EWCA Civ 229, the Court of Appeal considered whether a broad ‘consequential loss’ exclusion clause (along with a limitation of liability clause) precluded the granting of an interim injunction to restrain a breach of contract in advance of it taking place.

Granting the injunction, the Court of Appeal decided that it did not and, in fact, the existence of such ‘consequential loss’ and limitations clauses made the granting of an interim injunction restraining a breach of contract more likely.

Although this is not an energy industry case, the Court of Appeal’s reasoning will be of critical interest to those negotiating broad contractual ‘consequential loss’ clauses (or other exclusion/limitation clauses) in the energy industry, as it indicates that interim injunctive relief is more likely available to restrain a breach where a broad ‘consequential loss’ (or exclusion/limitation) clause applies to damages that may otherwise arise from the breach in question.

Facts

The parties were involved in an arbitration dispute concerning the terms of a licence agreement when ‘AB’ (the Appellant) sought an interim injunction which required ‘CD’ (the Respondent) to continue performing its obligations under the disputed agreement. The Appellant wished to restrain the Respondent from terminating or suspending the agreement pending the arbitration award.

The licence agreement under consideration contained a broad ‘consequential loss’ clause, which excluded liability for ‘loss of data, lost profits, costs of procurement of substitute goods or services, or any exemplary, putative, indirect, special, consequential or incidental damages’ and also contained a limitation of liability (cap) on other damages that might nevertheless be recoverable.

Issues

In exercising its discretion to grant an interim injunction, the court relies on the *American Cyanamid Co (No 1) v Ethicon Ltd* [1975] UKHL 1 guidelines. The second stage of the court’s approach under these guidelines is to consider whether damages would be an adequate remedy to the applicant. An injunction is not generally granted in cases where damages would be an adequate remedy.

In this case, the issue of the adequacy of damages was complicated by the broad ‘consequential loss’ and limitation clause in the contract. In the High Court the judge noted that any award of damages would – by reason of the ‘consequential loss’ and limitation clause – be far less than the loss which could otherwise be recovered at common law. However, the High Court found that this was what the parties had agreed as ‘adequate damages’ in the event of a breach and the application for an injunction should be refused, as the applicant had an adequate remedy in damages in the agreed contractual sum.

The implication of this decision, if correct, was that it would be extremely difficult for an innocent party to succeed in an application for an interim injunction were a broad 'consequential loss' clause applied, as even though all damages may be excluded by the contract the Court would consider there to be 'adequate damages' available.

Permission to appeal was granted.

Court of Appeal Decision

The Court of Appeal overturned the High Court decision and granted an interim injunction to restrain the attempted termination of contract.

The Court of Appeal decided that the 'primary commercial expectation' under a contract is one of performance. In contrast, the expectations created by 'consequential loss' or limitation clauses are about the damages that will be recoverable in the event of breach and are therefore secondary to the performance obligation. Underhill LJ explained that 'an agreement to restrict the recoverability of damages in the event of a breach cannot be treated as an agreement to excuse performance of that primary obligation' and he thought that the importance of protecting the 'primary commercial expectation' of performance seemed to 'sit better with the acceptance by this Court that an injunction may in an appropriate case be granted even where the loss caused by the threatened breach would not sound in damages'.

Counsel for the Respondent noted the far reaching impact of the Court of Appeal's approach and argued that it would not be right that in every case where the innocent party of a threatened breach of contract sought an interim injunction it could rely on the existence of an exclusion or limitation clause to claim that damages would not be an adequate remedy.

However, Underhill LJ explained that he thought Counsel for the Respondent overstated the consequences of the case and a 'claimant will still have to show that if the threatened breach occurs there is (at least) a substantial risk that he will suffer loss that would otherwise be recoverable but for which he will (or at least may) be prevented from recovering in full, or at all, by the provision in question'.

Comment

This case has specific resonance to those in the energy industry where wide 'consequential loss', exclusion and limitation clauses are commonplace. Such broad exclusions had previously been understood to remove the possibility of obtaining any remedy (whether by damages or interim injunctive relief), as the 'damages' specified in the contract have been agreed to be the 'adequate' remedy for a breach. However, *AB v CD* suggests that broad exclusion clauses could actually have the opposite impact and increase the likelihood of the courts granting interim injunctive relief to an innocent party to restrain a threatened breach of contract. As Laws LJ noted, in circumstances where a limitation clause exists in a contract, justice will tend to 'favour the grant of an injunction to prohibit the breach in the first place'.

It is unlikely that this case will mean that parties refrain from putting 'consequential loss' or limitation of liability clauses in contracts. However, it serves as a reminder that such clauses may not prevent interim injunctive relief being granted to restrain a breach. In fact, it seems that they will make the grant of such interim relief more likely. As a consequence, a party's usual ability to walk away from a contractual obligation by paying damages for its breach might be restricted by the existence of such a clause.

Consequential Loss: LOGIC Contracts – loss of profits for repudiatory breach

The article at page 26 'LOGIC – remedying default to the innocent party's satisfaction' relates to termination for failure to remedy defects to the company's satisfaction under LOGIC contracts. In the same case, *Bluewater Energy Services BV v Mercon Steel Structures BV* [2014] EWHC 2132 (TCC), the High Court expressed some views on whether a LOGIC contract would entitle the innocent party to claim 'loss of profits' in the event that the contract was wrongfully terminated.

Although this aspect of the decision is not binding, the Court suggested that the innocent party would not be able to claim loss of profits – potentially leaving it without a remedy.

Facts

On 26 March 2007, Bluewater entered into a sub-contract with Mercon for the fabrication of a tower based soft yoke system ('**SYMS**') for installation as part of the development of the Yuri Korchagain Field in the Caspian Sea.

The Contract contained the usual LOGIC exclusion for Consequential Loss that stated:

> 'For the purpose of this Clause 25 the expression 'Consequential Loss' shall mean loss and/or deferral of production, loss of product, loss of use, loss of revenue, profit or anticipated profit (if any), in each case whether direct or indirect, and whether or not foreseeable at the EFFECTIVE DATE OF COMMENCEMENT OF THE CONTRACT.
>
> Notwithstanding any provision to the contrary elsewhere in the CONTRACT and except to the extent of any agreed liquidated damages provided for in the CONTRACT, BLUEWATER shall save, indemnify, defend and hold harmless the CONTRACTOR GROUP from the BLUEWATER GROUP's own Consequential Loss and the CONTRACTOR shall save, indemnify, defend and hold harmless the BLUWATER GROUP from the CONTRACTOR GROUP's own Consequential Loss.'

Accordingly, if Bluewater had wrongfully terminated the contract, the issue to be determined was whether Mercon was entitled to its lost profits.

Decision

In the event, the High Court decided that Bluewater had not wrongfully terminated the contract, so the issue did not form an important element of the Court's decision.

However, the Court did offer the view, obiter, that:

- The parties had sought to agree their own definition of 'Consequential Loss' for the purpose of Clause 25.
- It follows that the meaning of consequential loss must be found from within the contract, rather than cases relating to 'indirect loss' under Hadley v Baxendale.
- The parties had broadened the definition to avoid any distinction between direct or indirect loss and had therefore eliminated any requirement for the loss to be foreseeable.
- The parties carefully chose that definition which, on its face, clearly applied to loss of profit or anticipated profit by Mercon which arose from a wrongful termination of the Contract.
- In those circumstances, even if the Court had found that there was a repudiatory breach arising from the wrongful termination of the Contract, it did not consider that Mercon could recover loss of profit or anticipated profit.
- Equally, Bluewater could not claim any loss of profit arising from Mercon's breach of contract.

Comment

The High Court's decision is arguably in contrast to recent Court of Appeal decisions that have sought to limit the scope of exclusion clauses relating to consequential loss. The arguments in relation to this point seem to have been limited, and it is not apparent whether the full range of cases relevant to this issue were considered by the Court.

For example in *Kudos Catering (UK) Limited v Manchester Central Convention Complex Ltd.* [2013] EWCA Civ 38, the Court of Appeal decided that the words ' … shall have no liability whatsoever in contract, tort (including negligence) or otherwise for any loss of goodwill, business, revenue or profits… suffered by (Kudos) or any third party in relation to this Agreement…' did not exclude loss of profits for failure to perform the contract, as it would render the agreement devoid of contractual content.

Although the obiter of the High Court should be treated with caution, it remains one of the few references to Consequential Loss in the context of LOGIC contracts.

Consequential loss and Spread Costs

In *Transocean Drilling UK Ltd v Providence Resources plc* [2014] EWHC 4260 (Comm), the High Court recently sought to answer two burning questions which are regularly raised in the context of drilling unit contracts in deciding that: (1) the rate applicable during periods of breakdown was not payable when the breakdown occurred due to a breach of contract by Contractor; and (2) a consequential loss clause, similar to the form found in many equivalent agreements, did not exclude a Company's right to claim its 'spread costs' against a Contractor during periods of Contractor default.

Although drilling unit contracts will vary in wording, the reasoning of the High Court sets important benchmarks/guidelines for those drafting or negotiating drilling unit contracts.

Facts

The Claimant/Contractor ('**Transocean**') provided the rig GSF Arctic III (the '**Rig**') to the Defendant/Company ('**Providence**') pursuant to a drilling contract dated 15 April 2011 (the '**Contract**'). The Rig was a six-leg semi-submersible drilling unit built in 1984. The dispute related to the financial consequences of delays which occurred to the drilling of an appraisal well in the Barryroe field off the south coast of Ireland between November 2011 and March 2012.

The delays occurred following problems with the Blow Out Preventer (**'BOP'**) stack, between 18 December 2011, when operations were first interrupted as a result of BOP misalignment problems, and 2 February 2012 when the Rig was in a position to resume operations. This period was described by the parties as 'the Disputed Period'.

Transocean claimed remuneration of US$13,035,083.97 and £3,516,758.45 in accordance with the rates provided for in the Contract together with reimbursables. Only a minority of this amount arose in respect of the Disputed Period.

Providence contended that (1) in respect of the remuneration claim for the Disputed Period, it was not liable for periods of delay caused by breaches of contract by Transocean and (2) in respect of most of the balance of the remuneration claim, it was entitled to set off its counterclaim, which was for wasted costs comprising 'spread costs'.

The Contract

The Contract included the following day rates: Daily Operating Rate of US$250,000, Standby Rate of US$245,000, Fishing Rate of US$245,000, Redrill Rate of US$225,000, Repair Rate of US$245,000, Force Majeure Rate of US$225,000 and Waiting for Weather Rate of US$245,000. The Repair Rate was expressed to apply as follows:

> 'Except as otherwise provided, the Repair Rate will apply in the event of any failure of [Transocean's] equipment (including without limitation, non-routine inspection, repair and replacement which results in shutdown of operations under this CONTRACT including the time up to recommencement of [Providence's] operations at the same point (including any trip time, eg 'drill to drill') as when the failure occurred excluding any period when the failure has been remedied but operations cannot proceed due to adverse weather or sea conditions, or while waiting on [Providence's] instructions, materials or services or any period of time when the failure or repair has been caused due to an act or omission of any member of [Providence's Group] or a Force Majeure Event…'

The Contract also contained a broad exclusion of 'Consequential Loss' that was defined to mean:

> '(i) any indirect or consequential loss or damages under English law, and/or
>
> (ii) to the extent not covered by (i) above, loss or deferment of production, loss of product, loss of use (including, without limitation, loss of use or the cost of use of property, equipment, materials and services including without limitation, those provided by contractors or subcontractors of every tier or by third parties), loss of business and business interruption, loss of revenue (which for the avoidance of doubt shall not include payments due to [Transocean] by way of remuneration under this CONTRACT), loss of profit or anticipated profit, loss and/or deferral of drilling rights and/or loss, restriction or forfeiture of licence, concession or field interests'.

In respect of rates to be paid during the Disputed Period, Transocean argued that the rates listed in the Contract were a complete code (exclusive list of rates for all events) and, in accordance with the 'knock for knock' provisions common in the industry, were to be applied regardless of fault. In fact, some rates, such as the Redrill Rate and Fishing Rate gave a clear indication that rates applied even if Transocean was negligent.

In relation to 'spread costs', Transocean argued that the spread costs claimed were 'loss of use' for the purposes of the second limb of the Consequential Loss definition and recovery was therefore excluded.

Decision

The Court disagreed with Transocean on both points of contractual construction.

In relation to the rate due during the period of breakdown, the Court reasoned:

- The starting point was the well-known line of authorities that, absent clear language, a clause will not be construed as enabling a party to take advantage of its own breach.
- The principles applicable to interpreting rig contracts were the same as any other contract for goods/services, and it did not assist Transocean to argue that such contracts are generally 'knock-for-knock'.
- In framing the remuneration provisions as being in return for Work, rather than reference to a particular period of time, it was indicative that any right to abatement for failure to perform Work would be preserved.
- There was express provision for Transocean to exercise care. It was inherently unlikely Providence intended to make payment if Transocean was in breach of such provision.
- If Transocean was correct, it would be entitled to payment for periods where delays were caused by its own deliberate breach – which indicates that the interpretation was not correct.

— It followed that, in the absence of express indiction to the contrary, the Repair Rate (or any other rate) was not due if the breakdown was for Contractor fault.

— The Court also considered that the law of abatement may be relevant in these circumstances, where the value of performance was diminished by breach.

In relation to 'spread costs' the parties agreed that:

— 'consequential loss' (undefined) meant the second limb of *Hadley v Baxendale*.

— 'Spread costs' fell within the first limb of *Hadley v Baxendale* i.e. direct losses.

— The question was therefore whether the additional words in the second limb of the Consequential Loss definition for 'loss of use' etc. excluded direct 'spread costs'.

The Court decided that the additional words used did not exclude 'spread costs'. The words 'loss of use' meant loss of benefit/profit from the equipment or property under contract. In this respect the Court reiterated that exclusion clauses should be interpreted *contra preferentem*. The burden was on Transocean to establish that the words showed a clear intention of the parties to deprive Providence of a remedy to which it was otherwise entitled. Transocean did not discharge such burden.

Comment

It remains open to the parties to agree an alternative allocation of risk and loss in a drilling unit contract to that in this case. However, the clear implication of the Court's decision is that, absent express words, the English Courts will be slow to find that: (1) a contractor is entitled to payment of a breakdown rate when the breakdown is due to a contractual breach by the contractor; and (2) a broad, unspecific, 'consequential loss' clause will be unlikely to exclude a company's right to claim its 'spread costs' in the event of delay due to its contractor's breach/default.

Although drilling unit contracts will vary in wording, the reasoning of the High Court sets important benchmarks/guidelines for those drafting or negotiating such contracts. In the context of drilling units subject to external finance, with the daily rate being relied upon to pay down debt, the wording of the drilling unit contract concerning breakdown rates and the exclusion for claims for 'spread costs' could have particularly important implications for the finance parties as well as the contractor.

The case is currently under appeal concerning the spread costs element of the judgment.

Mergers & Acquisitions

In any M&A deal a party is entitled to drive a hard bargain. Sometimes this can involve 'sailing close to the wind'. However, it is important to appreciate the boundaries between merely negotiating hard and impermissible conduct. The High Court has recently considered two cases concerning: (i) good faith during exclusivity periods and (ii) the line between mere silence and deceit. The cases confirm that English law will not prevent a party from negotiating hard and taking advantage of its commercial strengths.

Genuine negotiations vs deceitful statements

In *Leni Gas & Oil Investments Limited, Leni Gas & Oil plc v Malta Oil Pty Limited, Phoenicia Energy Co Limited* [2014] EWHC 893 (Comm), the High Court was recently asked to consider whether a representation concerning an oil and gas exploration block amounted to the tort of deceit. The case provides some comfort to those making statements during the course of transactions, as it clearly identifies that genuine negotiations (which may include withholding good news) and hard bargains do not, of themselves, give reason to doubt an individual's honesty and give rise to the tort of deceit.

Facts

The defendants (subsidiaries of Mediterranean Oil& Gas Plc) had a Production Sharing Contract (**'PSC'**) with the Government of Malta relating to Area 4, approximately 150 km offshore Malta, a 'frontier' exploration region. Leni Gas and Oil Plc and its subsidiary, Leni Gas & Oil Investments Ltd (together the claimants) held a 10% interest in the same area.

During a telephone conversation on 10 July 2012, the defendants' CEO told the claimants that a farm-out would be vital and that the defendants were opening a data room the following week. Following this conversation, on July 31, the claimants sold their 10% stake to the defendants for a nominal US$1 plus US$19,050 in past liabilities.

Less than a month later, the defendants signed a US$70m deal to sell a 75% interest in the same block to Genel Energy. Following the Genel deal, it is thought that the claimants' former stake could be worth around US$9m.

The claimants' case was that the statements made on 10 July 2012 were deliberately intended to create a false impression as to the true state of affairs. They claimed this induced them to sell their interest for substantially less than its true value and that the defendants' actions gave rise to a liability in deceit.

Issues

The elements of a tort of deceit are as follows: (i) a representation, which is (ii) false, (iii) dishonestly made, and (iv) intended to be relied upon and in fact relied on.

The principal issues were threefold, whether: (i) the defendant's CEO intended to make the representation alleged; (ii) the claimants' CEO had understood that such a representation was being made; and (iii) that representation caused the claimants to agree to sell their interest to the defendants.

The claimants claimed that the defendants fraudulently induced them to sell their 10% interest for substantially less than its true value when they would not otherwise have done so. They claimed the defendants' CEO fraudulently represented that the process for the 'farming-out' of part of the defendants' 90% interest in the block 'had not yet begun in earnest' and that the defendants were 'not yet in negotiations or discussions (alternatively serious negotiations or discussions) with any potential farmee'.

The truth of the CEO's actual statements, that a farm-out would be vital and the defendants were opening a data room in London the following week, was not disputed. However the claimants said fraudulent representations were implicit in the CEO's statement and that these were deliberately intended to create a false impression as to the true state of affairs. This, they claimed, amounted to deceit.

Decision

The High Court found in favour of the defendants: that no representation or implied representation was made. Further, the claimants did not understand such a representation had been made and that, even if they had, the representation had not caused the claimants to sell their interest.

The court considered that the defendants' CEO was a 'skilled and successful negotiator', but did not find this to be a reason to doubt his honesty. The court distinguished between the defendants' 'suppression of good news' (which, the court found, should rightly have been regarded as highly confidential and as such there was no duty to disclose) and the claimants' unsupported conclusion that what was said about the data room was intended to deceive.

In contrast, the judge criticised the consistency of the claimants' witness evidence, finding their accounts of the critical conversation unconvincing and contrary to the plain meaning of contemporary notes.

Comment

This case demonstrates that English law acknowledges the power of negotiators to drive a hard bargain. As always, it is important not to be deceitful in negotiations; half-truths may amount to deceit. However, there is no general duty of disclosure, particularly where the information is confidential.

As Mr Justice Males noted, 'it may have seemed to (the claimants) that the prospectivity for these proceedings and the amount at stake were such that the economics of this litigation were positive. However, litigation like the oil business is a high risk activity and (the claimants have) failed to strike oil'. The Court further demonstrated its displeasure with the claimants' conduct of the case by awarding costs on an indemnity basis (meaning that the receiving party, in this case the defendants, will obtain a higher legal cost recovery).

Good Faith and Exclusivity

As in most parts of the business world, the concept of good faith negotiations during a period of exclusivity is familiar to the oil and gas industry. It is market practice in many instances to provide for exclusive good faith negotiations for a fixed period under an English law contract. Such contracts may also contain a right to recover the costs of abortive negotiations from the other side. These issues were re-visited recently in the High Court case of *Knatchbull-Hugessen and others v SISU Capital Ltd* [2014] EWHC 1194 (QB).

Facts

The Alan Edward Higgs Charity (the '**Charity**') filed a claim before the court for recovery of professional fees and other related costs against SISU Capital Limited ('**SISU**'), a London based investment management company. The Charity and SISU entered into negotiations for SISU to purchase a 50% share of Arena Coventry Limited ('**ACL**') from the Charity. ACL owned and operated the Ricoh Arena in Coventry, home to the Coventry Football Club ('**Club**'), and the Club had a license from a subsidiary of ACL to use the Club. When the Club went into financial difficulty in March 2012, SISU (who owned the Club) decided to enter into negotiations with the Charity to purchase the stake in ACL. Indicative terms for a share purchase agreement were agreed in a Term Sheet which was signed in June 2012.

Issues

Two terms of the Term Sheet were relevant to the dispute. The first was a provision that SISU would pay the Charity's costs up to a maximum of £29,000 in the event that the transaction was not concluded due to certain condition precedents in the term sheet not having been fulfilled. The second was an exclusivity provision for the parties to negotiate for a period of six weeks in good faith. The exclusivity period expired in July 2012 without any share purchase agreement having been signed. The Charity subsequently obtained further financing, and in doing so, made the fulfillment of one of the condition precedents impossible. The Charity later brought an action against SISU for £29,000 for costs, and SISU counterclaimed for breach of an implied term of good faith and an obligation not to do anything which would render impossible or materially impede the fulfillment of the conditions precedent.

Decision

The High Court upheld the view that where the agreement provided for a period of exclusivity and negotiations in good faith during that period, with a view to concluding a legally binding share purchase agreement, it was impossible to imply an undertaking by the Charity to conduct negotiations with SISU in good faith after the end of the exclusivity period. There was also no scope for implying a term into the agreement which would require the Charity to not do anything which would prevent the fulfillment of any condition precedent after the exclusivity period. Both terms if implied as argued by SISU would be inconsistent with the parties' agreement, and clear words in the agreement to that effect would have been required. There was nothing suggested in the parties' agreement that this was intended. SISU's counterclaim was dismissed, and it remained to be seen whether the Charity could recover its costs.

Comment

There is no general duty in English law to conduct negotiations in good faith. Nor is there any restriction on negotiating concurrently with multiple parties without informing such parties of each other's existence. As a general rule, costs incurred as a result of failed negotiations are not recoverable from the other party, even where negotiations fail because the other party acts unreasonably or chooses to contract with someone else.

Despite the generally accepted practice of parties agreeing to impose an obligation on one or both parties to conduct negotiations in good faith, it is important to bear in mind that the default position will apply unless the parties agree otherwise. The Court upheld this view: where the contract provided for a period of exclusivity and negotiations in good faith with a view to concluding a legally binding share purchase agreement, it was impossible to imply into that agreement an undertaking by the seller to conduct negotiations with the prospective buyer in good faith after the end of the exclusivity period. Such a term would be inconsistent with the parties' agreement. In this regard *Knatchbull-Hugessen* should act as a reminder to oil and gas companies of the finite nature of exclusive negotiation periods.

No force majeure during field shut-in

In a case of interest to the natural gas industry, the Appellate Division of the Superior Court in New Jersey recently decided in *Hess Corporation v Eni Petroleum US*, LLC, 435 N.J.Super.39 (App. Div 2014) that a seller could not rely on a force majeure provision within a natural gas supply contract. In this instance the supply of gas from the seller's fields (located near the delivery point), was prevented by the loss of transportation in an intermediate transportation system. The court decided that the seller could deliver gas to the delivery point using a different source and transportation route, which would likely necessitate it buying gas from elsewhere to fulfil its obligations.

Although a New York law case, it is likely that English law would reach the same result. The decision highlights the importance of carefully drafting force majeure clauses in gas sale and purchase contracts where there may be multiple potential sources of gas and/or gas supply routes

Force Majeure in English law

In English law there is no common law concept of force majeure. In the absence of a force majeure clause in an English law agreement, a party seeking relief from performance for reasons beyond its control has only the common law remedy of frustration; if there is no other express standard of performance stated in the agreement. This is unlikely in the case of a sellers' obligation to deliver quantities within the annual and daily contract quantities. As one of the requirements for frustration is that the event must render further performance of the contract impossible, if there is an alternative method of performance of the obligation, a claim for frustration may be unsuccessful. As a consequence of the limited remedy offered by frustration and counterparties' preference for structured allocation of risk for non-performance through the supply chain, force majeure clauses are an essential part of natural gas sale and purchase contracts.

Facts

Hess Corporation (the '**Buyer**') and Eni USA Gas Marketing LLC (the '**Seller**') (together, the '**parties**') entered into a contract (the '**Contract**') for the sale and purchase of 20,000 MMBtu/day of natural gas, with delivery taking place at the 2i – Zone L – 500 Leg pooling area of the Tennessee 500 (the '**Delivery Point**').The Seller produced gas from wells located in the Gulf of Mexico which were connected through underwater pipelines to the Independence Hub ('**I-Hub**'), a floating platform in the Gulf, approximately 195 miles off the coast of Louisiana. Other producers also sent gas to the I-Hub. Once in the I-Hub, the gas was comingled, processed and transported via the Independence Trail Pipeline, owned and operated by Enterprise, to another platform in the Gulf called the West Delta 68. From there the gas was then transported to the Delivery Point, where it was pooled.

The Contract was based upon a pro forma template that promoted a flexible contracting approach, consisting of a number of provisions to be completed by the parties as they deemed necessary to reflect the nature of the specific transaction. In this case, the parties did not complete the 'transporter' information and did not include any 'Special Conditions', such as identifying the

origin of the gas. As a consequence, the Contract did not require the gas that was the subject matter of the Contract to have been produced from a specified field or to have been transported to the Delivery Point via a specified route.

The Contract contained a standard force majeure provision which stated that 'neither party shall be liable to the other for failure to perform a firm obligation, to the extent that such failure was caused by a Force Majeure'. The Contract further stated that 'Force Majeure shall include, but not be limited to… interruption and/or curtailment of firm transportation and/or storage by Transporters…'

On 8 April 2008, a leak in the Independence Trail Pipeline resulted in Enterprise ceasing all gas transportation through the pipeline. This resulted in the Seller being unable to ship gas from its production fields through the I-Hub to the Delivery Point. The Seller claimed force majeure under the Contract and argued that it no longer had an obligation to perform under the Contract on the grounds that the Contract expressly included as a force majeure event an interruption and/or curtailment of firm transportation by a pipeline transporter. The Buyer disputed the force majeure claim.

Decision and Reasoning

The Appellate Division of the Superior Court in New Jersey held that the Seller's performance under the Contract should not be excused on the grounds of force majeure.

The Court found that the Seller had agreed to provide a specific quantity of gas at a specified delivery point (the Tennessee 500) and that nothing in the Contract obliged the Seller to ship the gas to the Delivery Point via a specific transporter or pipeline route, or for the gas to have been produced from a specific source. The Delivery Point itself was unaffected by the events causing the alleged force majeure and alternative sources of natural gas were available at the Delivery Point at such time. There was nothing in the Contract that prevented the Seller from purchasing natural gas from other sources and supplying it to the Buyer at the Delivery Point. Therefore the Seller had breached its obligations to deliver to the Delivery Point and sell to the Buyer natural gas in the contract quantities in accordance with the terms of the Contract.

The Court distinguished the facts of this case from those in *Virginia Power Energy Marketing Inc.* ('**VPEM**') *v Apache Corporation* ('**Apache**') *(Case number 14-07-00787-CV, 6 August 2009 in the Court of Appeal of the State of Texas)*, which involved a force majeure claim under an identical clause to that set out in the Contract. The parties in Virginia Power had expressly agreed that Apache was to deliver gas to a specific delivery point. However, the specified delivery point itself had been damaged to such an extent that delivery was impossible. The Court therefore decided in that case that Apache could rely on a force majeure clause and was not obliged to find an alternative delivery point at which to fulfil its sale obligations under the contract.

Comment

It is likely that English law would have reached the same conclusion as the New Jersey Superior Court on the facts of this case. Analogous authority on this point exists in an English shipping law case (*Warinco AG v Fritz Mauthner* [1978] 1 Lloyd's Rep), in which the terms of a sale of goods agreement provided that an exception to the delivery obligation would apply upon prohibition of export from the loading ports specified in the agreement. Exports were prohibited from a jurisdiction in which one of the ports was located and the seller unsuccessfully sought to have performance excused on the basis of the exception. The Court decided that the seller would continue to be bound if the prohibition of export only affected one of the ports, unless it could show that, having made reasonable efforts, it could not have shipped from any one of the other ports goods of the contractual description within the contractual time for shipment.

Subject to the drafting of the force majeure provision, it would therefore be challenging for a natural gas seller under an English law-governed sale and purchase agreement to successfully claim force majeure and have its delivery obligations excused where such delivery is to take place at a location that has sufficient liquidity in terms of alternative sources of gas supply provided a force majeure event does not affect such location itself.

The decision of the New Jersey court highlights the importance of sellers paying careful attention to the drafting of force majeure clauses. In negotiating and drafting a force majeure provision, sellers will need to keep in mind many significant factors, including: whether it intends to source hydrocarbons from a dedicated field(s) or sell hydrocarbons from a non-dedicated source; its ability to substitute gas from different sources or means of transportation; and trading constraints imposed by the market in which the gas is delivered. When selling gas within a trading system or hub, the seller will need to ensure the force majeure provisions reflect any relevant codes and/or market rules.

International arbitration update

The vast majority of international oil & gas contracts contain clauses referring disputes to final resolution by international arbitration. For this reason, it is worthwhile keeping abreast of developments in international arbitration, particularly those developments that may have an impact on the drafting of arbitration clauses.

However, the agreement to arbitrate is typically one of the last, and least well-considered, contractual provisions to be negotiated. Poorly-drafted arbitration clauses continue to be considered by the English courts, including a notable recent decision confirming the importance of the 'seat' to international arbitration agreements.

Arbitration clauses: English Court confirms seat is critical

International arbitration distinguishes between the law that the arbitral tribunal will apply to determine the dispute (i.e. the governing law), the law of the arbitration agreement and the law that governs the arbitral process. The governing law of the underlying agreement will determine the dispute, and the seat of the arbitration will determine the jurisdiction and laws applicable to the arbitral process.

As such, identifying the seat of the arbitration can be as important as identifying the governing law of the underlying agreement. This was reinforced by the English High Court decision in *Yukos Capital S.a.r.L v OJSC Rosneft Oil Co* [2014] EWHC 2188.

Background

The decision concerned a number of arbitral awards made in favour of Yukos against Rosneft, which were subsequently annulled by the Russian Courts (the '**Awards**'). The Dutch courts had granted leave for Yukos to enforce the Awards which were paid to Yukos. Yukos then claimed post-award interest in the English Courts. However, Rosneft claimed that the Awards no longer existed as they had been annulled by the Russian Courts, meaning the Awards could not be valid and binding on the parties.

Decision

Since the parties had submitted to the supervisory jurisdiction of the Russian Courts in their agreement to arbitrate, the decisions of those Courts would normally have been determinative. However, the English Court acknowledged that it should not be bound to recognise a decision of a foreign Court which offended against '*basic principles of honesty, natural justice and domestic concepts of public policy.*' It was therefore open for Yukos to argue that no effect should be given to the annulment of the Awards by the Russian Courts based on those principles.

Comment

This decision should provide a degree of comfort to parties who find that the specific seat of an arbitration equates to a real risk that decisions sought from that jurisdiction's Courts in relation to the arbitration will be partial. However, the decision also highlights the very limited circumstances in which the English Courts are willing to enforce an arbitral award set aside by Courts in the seat of the arbitration. Absent exceptional circumstances, such as breaches by the foreign Court of rules of natural justice, fraud and/or for reasons of public policy, the English Courts will not enforce the annulled arbitral award.

The important lesson for drafters is that prevention is better than cure. The content of dispute resolution clauses, and how those clauses will operate practically, can be overlooked during the negotiation of transactions when parties are understandably focused on the commercial details of the transaction. Parties should, however, take care to consider how dispute resolution clauses will operate if engaged and, particularly in light of this case, ensure they do not enter into arbitration agreements that provide for a seat where the local Courts may not support the arbitral award or process.

Interim Orders and Section 44 of the Arbitration Act 1996

A recent decision of the English Commercial Court has clarified the power of the courts to grant urgent interim relief under Section 44 of the English Arbitration Act 1996 (the '**Act**'). The decision continues to highlight the English judiciary's reluctance to interfere with the parties' agreement to arbitrate, and reinforces the Courts' generally pro-arbitration stance.

Background

In *AB International (HK) Holdings Plc Ltd & Anor v AB Clearing Corporation Ltd & Ors* [2015] EWHC 2196 (Comm) ('**AB International**'), the claimants made an urgent application for interim relief under Section 44(3) of the Act to seek disclosure of information from the defendants.

Section 44(3) of the Act provides that:

'If the case is one of urgency, the court may, on the application of a party or proposed party to the arbitral proceedings, make such orders as it thinks necessary for the purpose of preserving evidence or assets'.

The claimant argued that disclosure was required in order to preserve the business of a joint venture which was arguably not receiving the profits that it ought to have been receiving from the defendants' companies.

Decision

In its judgment, the court refused to grant such a disclosure because the claimants had failed to establish that there was any urgency or necessity for the order sought. Instead, the Court felt that, once appointed, the arbitrators could order the disclosure if they felt it was appropriate. Consequently, the Court considered making such orders '*would be an interference by the court in the arbitration process where there seems to be no reason why the arbitrators will not be able to act effectively*'.

The Court also queried why such an order would be necessary in circumstances where the claimants were not relying on the arbitration '*to produce an award of the trading profits which will fund the JVC* (Joint Venture Company) *business*'.

Comment

AB International serves as a useful reminder that an application for interim relief in the English High Court, pursuant to Section 44 of the Act, where there are associated arbitral proceedings, requires the parties to (i) establish real urgency for such an order, (ii) provide reasons for necessity for such an order, and (iii) establish that such an order cannot be granted by an arbitral tribunal (whether already appointed or not).

Legislation	Brief summary of the legislation
Bribery Act	The Bribery Act criminalises various corruption offences. Its reforms include: — Criminalising business to business bribery; — Seeking to prevent bribery by the use of third parties; and — Extending to bribery outside the UK.
Sale of Goods Act 1979	The Sale of Goods Act implies a number of terms into contracts for the sale of goods including: — Good title; — No encumbrance and quiet possession; — Satisfactory quality; and — Fitness for purpose.
Supply of Goods and Services Act 1982	The Supply of Goods and Services Act implies similar terms as the Sale of Goods Act, but also implies terms that services will be carried out: — With reasonable skill and care; — Within a reasonable time; and — For a reasonable price.
Unfair Contract Terms Act 1977	The Unfair Contract Terms Act imposes limits on the extent to which liability for breach of contract, negligence or other breaches of duty can be avoided by means of contractual provisions such as exclusion clauses.
Law Reform (Contributory Negligence) Act 1945	The Law Reform (Contributory Negligence) Act provides that the damages recoverable by a claimant whose negligence has contributed to the damage can be reduced in accordance with what is just and equitable in the view of the court.

Applies to contracts performed outside UK where the governing law of the contract is English law	Applies to contracts performed outside UK where the governing law of the contract and the parties' non-contractual obligations is English law
Y (provided, for the Corporate Offence, that company or partnership is incorporated, or 'carries on a business, or part of a business' in any part of the UK)	
Y	Y
Y	Y
N	N
Y	Y

Legislation	Brief summary of the legislation
Civil Liability (Contribution) Act 1978	The Civil Liability (Contribution) Act provides that any person liable for damage suffered by another person may recover a contribution from any other person liable in respect of the same damage.
Misrepresentation Act 1967	The Misrepresentation Act allows a party to claim damages in respect of misrepresentations which have induced one party to enter into a contract. The Act also limits the parties' ability to exclude liability for such misrepresentations.
Late Payment of Commercial Debts (Interest) Act 1998	The Late Payment of Commercial Debts Act requires parties to specify a 'substantial remedy' for late payment and if no such remedy is specified, a penal interest rate will apply (presently 8.5%), together with an entitlement to the reasonable costs of recovering payment (which may include legal costs).

Applies to contracts performed outside UK where the governing law of the contract is English law	**Applies to contracts performed outside UK where the governing law of the contract and the parties' non-contractual obligations is English law**
N (The same result can be achieved through contractual indemnity provisions, however)	
Y	Y
Y (if there is also a sufficient connection with the UK)	Y (if there is also a sufficient connection with the UK)

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