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Annual Review of developments in English oil and gas law

2021 Edition

Contents

Previous editions

Previous editions of the CMS Annual Review of developments in English oil and gas law are available at **cms.law**.

Welcome to the 2021 edition of the CMS Annual Review of developments in English oil and gas law.

I think it would be fair to say that the past twelve months have not quite turned out as most people anticipated. This year's edition of the Oil and Gas Annual Review demonstrates the continuing challenges posed by the global pandemic, but also the opportunities that have resulted from it. Courts and arbitral tribunals have managed the shift to online hearings, which has not impacted their ability to deliver judgments and awards at a rate no different to pre-pandemic levels. We therefore continue to see an impressive body of guidance developed by the courts and arbitral tribunals that is relevant to all oil and gas lawyers. Companies and government agencies involved with the oil and gas industry have also seized the opportunity to rethink, restructure and adapt to the new global order, which is evident in the know-how encompassed in this year's Annual Review.

While many of the cases where judgments and awards have been delivered were commenced, and relate to facts and matters, which occurred prior to the COVID-19 pandemic, inevitably this year's Annual Review includes a few decisions which have considered the effects of the pandemic. Amongst them are the first COVID-related 'Material Adverse Effect' dispute to come before the English courts as well as a recent High Court decision on the implied duty to exercise the unilateral right to designate a force majeure event in good faith and in a rational manner.

We have also seen interesting court decisions and arbitral awards relating to issues as diverse as termination of oil sale agreements for buyer default after payment was made and the right of the buyer to recover its money, resolving inconsistent quality determination provisions for the sale of fuel oil, issues with interpretation of the Petroleum Act 1998 with regards to its decommissioning provisions and their apparent conflict with BEIS guidance and general practice, and clarification as to the OGA's role in consent to change of control. Outside the oil and gas sector there have also been some interesting decisions and awards that illuminate issues relevant to oil and gas contracting – such as those relating to construction and engineering contracts or environmental and climate change issues. As before, the Annual Review seeks to capture as much of this relevant material as possible.

As always, any given case summary might relate to a multitude of issues. As a result, many articles that are contained within specific chapters of this year's Annual Review could equally be applicable to other chapters. They are in chapters for convenience only.

The Annual Review has been collated by our lawyers to be relevant to you, with a direct focus on legal developments affecting companies in the oil and gas industry. We hope that you find it interesting and of assistance in navigating the legal challenges and opportunities faced in the industry.

I would like to thank the many contributors across CMS for their articles, comments and assistance. Involving teams in London, Rio, Dubai, Singapore, Glasgow and Aberdeen, the Annual Review continues to be a global effort. It is not possible to mention all of those who have made significant contributions by name. However, I would like to give particular thanks to Anna Rose, Madalena Houlihan, Julia Czaplinska-Pakowska and Alexandra Smith, for their considerable efforts in assisting me collate this year's Annual Review, and David Rutherford, Aidan Steensma and Phil Reid, for their considerable contribution in writing Law-Now publications throughout the year on which much of this Annual Review is based. Finally, but by no means least, I would like to thank Valerie Allan for again providing the update on the UK regulatory regime – which is a critical issue for those dealing with the oil and gas sector on the UK Continental Shelf.

I hope you find this year's Annual Review useful to navigate the challenges that the oil and gas industry may face in the coming months. Please do not hesitate to contact us if you have any questions or feedback.

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Chapter 1

Joint Operating Agreements, Transportation Agreements and Decommissioning

The past twelve months have seen some important guidance from the Courts relating to joint ventures, transportation agreements and decommissioning, including relating to the proper interpretation of the scope of section 29 notices. Also, some non-energy industry cases have given important guidance on force majeure clauses and COVID-19:

— In *Apache UK Investment Limited v Esso Exploration and Production UK Limited* [2021] EWHC 1283 (Comm) the Commercial Court raised significant issues over the interpretation of the Petroleum Act 1998.

— In *Dwyer (UK Franchising) Ltd v Fredbar Ltd* [2021] EWHC 1218 (Ch) the High Court confirmed that where one party has the power to designate whether a force majeure has occurred the exercise of that power will be subject to implied terms.

High Court decision raises significant issues over the interpretation of the Petroleum Act 1998

The recent decision in *Apache UK Investment Limited v Esso Exploration and Production UK Limited* [2021] EWHC 1283 (Comm) shows how difficulties can arise when complex standard agreements are amended for particular circumstances. It also raises significant potential issues regarding the scope of the Petroleum Act 1998's provisions for decommissioning as the Commercial Court found that a section 29 notice applied only to infrastructure which either existed or was intended to be constructed at the time the notice was served. This appears to conflict with the approach of BEIS in its guidance and in practice.

Facts

The case concerned disputes as to the amount of security to be provided under decommissioning security agreements. It arose out of the purchase in 2011 by Apache UK Investment Limited ('**Apache**') from Esso Exploration and Production UK Limited ('**Esso**') of Mobil North Sea LLC ('**MNSL**'), which held licences in the Beryl, Buckland, Ness, Nevis, Skene and Maclure fields (the '**Fields**').

Apache and Esso entered into six Bilateral Decommissioning Security Agreements (the '**BDSAs**') in respect of the Fields, providing security in respect of Apache's obligation under the sale and purchase agreement ('**SPA**') to indemnify Esso for all decommissioning related expenditures which Esso was or might become liable to incur. The obligation to indemnify was further supported by a parent company guarantee provided by Apache Corporation, the ultimate parent company of Apache.

On 26 March 2020, Apache Corporation ceased to be a 'Qualifying Surety' under the BDSAs. Consequently, pursuant to the terms of the BDSAs, Apache was required to provide further security in the form of letters of credit. As the sums involved were substantial, the judge commented that *'Not surprisingly, Apache wish to provide as little security as is possible in accordance with their obligations, and Esso are by contrast concerned that they might end up under secured'*. Equally unsurprisingly, a dispute ensued regarding two matters:

— Whether on a proper construction of the BDSAs the required security was to be assessed in accordance with a 'Proposed Plan' which Apache put forward for 2021 or whether it should be assessed in accordance with a 'Proposed Plan' for 2020;

— Whether the Petroleum Act 1998 made Esso potentially liable for the decommissioning of certain wells and therefore those wells should form part of the property in respect of which security was due.

Security under the BDSAs

The BDSAs appear to have been based on the industry standard decommissioning security agreement ('**DSA**') with some modifications to reflect the fact that the security agreement was a bilateral arrangement for the particular circumstances of the SPA rather than the

field-wide arrangement for which the standard DSA is intended. In particular, under Clause 4.2 of the BDSAs Apache was obliged:

— To promptly notify Esso if the provider of the Affiliate Guarantee ceased to be a Qualifying Surety;

— To provide Esso with a Letter of Credit by way of security in the amount set out in Clause 5 of the BDSAs within 10 days of that event, namely by 5 April 2020.

On 26 March 2020, Apache Corporation ceased to be a 'Qualifying Surety' under the BDSAs. On 27 March 2020, Apache notified Esso of this, and indicated that it was currently arranging for the required letters of credit to be issued to Esso.

Clause 5 stipulated a 'Provision Amount' for 2011 and 2012. Apart from this, Clause 5 was largely consistent with the industry standard DSA. The Provision Amount was to be determined in accordance with the decommissioning plan for the 'Relevant Year'. However, under Clause 3 of the BDSA, there was no obligation on Apache to annually update that Plan unless and until Apache Corporation ceased to be a 'Qualifying Surety'. In that event Apache should within three (3) months submit to Esso a proposed decommissioning plan which should provide among other things an estimate of the highest 'Net Cost' during the immediately following year (such immediately following year being the 'Relevant Year'). Therefore, when Apache Corporation ceased to be a 'Qualifying Surety' in 2020 there was at that point no agreed decommissioning plan setting out a 'Provision Amount' for 2020 nor was there a 'Provision Amount' for 2019.

Clause 5.3 provided that if there was no 'Provision Amount' for the 'Relevant Year', then the 'Provision Amount' should be equal to the 'Initial Amount' and that this would be an 'Interim Amount' until the figures could be updated. Apache duly issued to Esso letters of credit in this amount which was approximately GBP 550m (the '**Letters of Credit**').

Clause 5.3 went on to provide that *'In the event that the Provision Amount for the Relevant Year for which the Interim Amount applies is subsequently approved, deemed approved or determined by the Expert pursuant to Clause 10 at a time in which Apache Corporation is not a Qualifying Surety, then Apache shall (subject to Clause 4.4) be obliged to provide a substitute Letter of Credit in the amount of the Provision Amount so approved, deemed approved or determined and Esso shall be obliged to return to Apache for cancellation the Letter of Credit in the amount of the Interim Amount promptly upon Esso's receipt of the new substituted Letter of Credit'.*

On 23 June 2020, Apache wrote to Esso enclosing a 'Proposed Plan' in respect of each of the BDSAs for the years 2020 and 2021 (the '**2020 Proposed Plan**' and the '**2021 Proposed Plan**'). On the basis of the 'Proposed Plan' for the year 2020, the relevant 'Provision Amount' for that year was GBP 412m. Since this sum was lower than the amounts of the Letters of Credit, Apache indicated that it would require Esso to return the Letters of Credit to Apache upon receipt of substitute letters of credit in the lower amount.

Esso objected that Apache had no obligation or right to submit the 2020 Proposed Plan under the terms of the BDSAs, and that it had therefore disregarded that document. Esso also raised various objections to the detail of the 2021 Proposed Plan.

Decision

Proposed Plan for 2020 or 2021

The first question to be considered by the Commercial Court was whether Clause 3 required Apache to present a 'Proposed Plan' for 2020 or 2021.

The Commercial Court agreed with Esso that the BDSAs required preparation of a plan for 2021 and not 2020. The Commercial Court noted that Clause 3.1 required Apache to provide a 'Proposed Plan' within 3 months for consideration by Esso which would update the historic figure initially provided in accordance with Clause 5. There was then a mechanism for objections to made, with possible referral to an expert, all of which might

take many months to complete. Clause 3.1.2 required the estimate of the cost to be for the *'immediately following Year (such immediately following Year being the Relevant Year)'*. The Commercial Court found that *'At any given date in 2020, the immediately following calendar year is 2021. Any other construction would be very surprising'*.

It was clear that the amendments made to the industry standard to address the particular circumstances of the acquisition created some ambiguity. The Commercial Court agreed that there was a significant difficulty in interpreting Clause 4.2 which provided that the obligation to provide Esso with a 'Letter of Credit' was *'in the amount equal to the Provision Amount stated in or calculated for the Relevant Year under Clause 5'*. The High Court commented that it was difficult to make sense of the addition of the words *'for the Relevant Year'* which were otiose at best and arguably misleading. It was also fair to say that the draftsman had not always used the expression 'Relevant Year' in a way entirely consistent with his definition: for example in Clause 5.1 there was reference to the *'2011 Relevant Year and 2012 Relevant Year'* which does not square particularly well with the definition '*immediately following Year*'.

However, there were, in the Commercial Court's view, more difficulties with Apache's construction. For example, if Apache Corporation had ceased to be a 'Qualifying Surety' in December 2020, on Apache's case, the process of submitting a 'Proposed Plan' would focus not on the security required for the coming year 2021 but the past year 2020, and the 'Proposed Plan' would not be submitted until early 2021 and probably agreed in mid-2021. Given Apache's submission that commercial common sense required these provisions to be construed so that accurate and up to date security could be provided, commercial common sense seemed very much on the side of Esso's construction. Further, it had led in the present case to Apache submitting two plans for consecutive calendar years at the same time. Nothing in the BDSAs suggested that was contemplated.

The Additional Wells

The second dispute between the parties was concerned with the extent of the potential decommissioning obligations of Esso under the Petroleum Act 1998 (the '**Act**').

The Act provides in section 29 that the Secretary of State may by written notice require the person(s) to whom the notice is given to submit to the Secretary of State an abandonment programme in relation to an offshore installation.

Section 30 sets out the persons to whom notices under section 29 may be given. Amongst other things, section 30 permits notices to be served on persons who have the right to exploit or explore mineral resources in any area (in other words, licensees under the Act in respect of the area) where the exploitation or exploration of mineral resources in the exercise of the right either is carried on from, by means of or on the installation, or the person intends to carry on such activity from, by means of or on the installation. Notices may also be served on companies associated with the licensees (essentially affiliates and 50:50 joint ventures).

Under section 34 of the Act, at the time a decommissioning programme is approved, if the Secretary of State has concerns regarding the financial resources of the companies then liable to carry it out, additional companies can be made liable if at any point previously they could have been served with a section 29 notice, even if they were not so served.

Esso objected when it received the Proposed Plans from Apache that Apache had failed to include in the 2021 Plan ten subsea wells relevant to the BDSAs, which it suggested could add approximately GBP 100m to the gross cost estimate. Following further correspondence between the parties, Esso refined this objection to only four additional wells located in the Nevis and Buckland Fields (the '**Additional Wells**').

The Additional Wells were drilled after Esso disposed of MNSL to Apache. The BDSAs required security to be given in relation to the decommissioning of 'Field Property'. This was defined to exclude new field facilities *'unless Esso or its Affiliates can be required to submit or carry out an abandonment programme in relation to such new field facilities under the terms of the Petroleum Act 1998'*.

The Secretary of State had served on MNSL prior to the sale and purchase a number of section 29 notices relating to 'subsea installations' for the Nevis Field and Buckland Fields. Although MNSL had been sold to Apache, Esso remained potentially liable for the decommissioning of those 'subsea installations' under section 34 of the Act as an associated company of MNSL at the time of issue of the notice. The question is whether these notices covered the Additional Wells.

Esso's concern was that the Secretary of State would contend that, on a proper construction of the Act, the existing notices were wide enough to require decommissioning of the Additional Wells, and therefore unless provision was made for security under the 2021 Plan, Esso could be significantly unsecured.

OPRED Guidance issued in 2018 states: *'In circumstances where a section 29 notice is not withdrawn from a party that has disposed of its interest (see below) they would not be liable for any new installations or pipelines emplaced in the field. In these cases OPRED will prepare a separate section 29 notice referencing the new installations and the relevant parties. However, the exiting party would be liable for any new equipment added to an installation already covered by their existing notice'* (emphasis added).

Esso sought to engage with OPRED (the division of BEIS responsible for offshore decommissioning), on the basis that if OPRED was prepared to accept that the section 29 notices issued before Esso sold MNSL to Apache did not apply to the Additional Wells, Esso would accept that Apache did not need to provide security for their decommissioning. However, OPRED indicated to Esso that it was of the view that Esso could be liable under section 34 for the Additional Wells. The Commercial Court considered that *'ultimately this is a question of construction of the Act and OPRED's views would not be determinative'.*

The matter appeared to turn on whether the Additional Wells fell within the definition of offshore installation under the Act. '**Offshore installation**' is defined by section 44(1) as *'any installation which is or has been maintained or is intended to be established for the carrying on of any activity'* falling within section 44(2) and (3). Those activities are by section 44(3) the exploitation or the exploration with a view to exploitation, of mineral resources in or under the shore or bed of relevant waters. By section 44(2) that activity must be carried on from, by means of or on an installation which is maintained in the water, or on the foreshore or other land intermittently covered with water, and not connected with dry land by a permanent structure providing access at all times and for all purposes. By section 44(5) 'installation' includes any floating structure or device maintained on a station by whatever means.

The Commercial Court focused on the fact that section 44(1) limits the powers in relation to offshore installations to an installation which is or has been maintained or is intended to be established: *'Thus the Secretary of State would only have power to apply one*

of the section 29 notices to the Additional Wells if at the time of the relevant notice those wells were being maintained or were 'intended to be established''.
No one has ever suggested that there was an intention at the time of the notices to construct any of the Additional Wells, which were only built many years thereafter. The Commercial Court considered that there is no possible reason to think that the Additional Wells could fall within the section 29 notices on the basis that they fell within *'intended to be established'*.

The Commercial Court therefore concluded that the security did not require to include provision in relation to the Additional Wells.

Comment

The commercial purpose of the BDSAs was to provide security in respect of Apache's obligation under the SPA to indemnify Esso for all decommissioning related expenditures which Esso was or might become liable to incur. Those liabilities could arise in the event the Secretary of State required Esso to carry out decommissioning, notwithstanding it had disposed of the assets, by virtue of a section 29 notice issued under the Act or through section 34. The scope of Esso's liability under a section 29 notice was therefore key to understanding the extent of the security needed to cover the scope of the indemnity in the SPA.

It is arguable that the analysis of the Commercial Court jumped from the requirement for the installation to have been established or intended to be established to a requirement for the well to have been established or intended to be established. The alternative approach (which was briefly considered but rejected) is whether the well formed a later addition to an installation which had been established/intended at the time of the notice. This decision, if correct, has some interesting implications for industry.

— First, it is notable that the Commercial Court appears to have been proceeding on the basis that a well was itself capable of being an installation, which is inconsistent with the approach taken to date by BEIS, which has treated 'installation' as referring only to a platform or subsea manifold structure. However, although installation is commonly understood in the industry to be so limited, it is not immediately apparent that there is anything in the definition of installation which would prevent the Commercial Court's interpretation. Although in practice, production and injection wells are included (and indeed expected by OPRED to be included) within decommissioning plans this approach would potentially extend Part IV of the Act to exploration and appraisal wells which has never previously been considered to be the case.

— Second, the Commercial Court's interpretation of the section 29 notice as applying only to infrastructure in place or intended to be in place at the time of the service of the notice creates issues for BEIS in determining what constitutes an addition to such an installation and what constitutes a new installation requiring a new notice. It may require BEIS to regularly update section 29 notices and/or issue many more notices, particularly where there have been amendments to the 'field development plan', in order to capture such additions within the new section 29 notice rather than assuming that a single notice would capture later additions to an installation. That in turn raises questions as to the scope of liability of those caught by the earlier notice who are no longer owners by the time of the later notice.

In simple terms, either:

— The Commercial Court's decision is wrong, which means Esso will not be receiving adequate security under the BDSAs as a result of this decision; or

— BEIS has been acting on a mistaken belief on the scope of existing section 29 notices and may now need to take action to seek to remedy the position.

Judge: Mr Hollander QC.

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CMS Expert Guide to Consequential Loss in the Energy Sector

Although not every jurisdiction recognises 'consequential loss' at law, clauses excluding 'consequential loss' can be encountered in energy contracts in almost every jurisdiction. However, the concept does not necessarily translate with ease across jurisdictions. In fact, the Courts in common law jurisdictions are questioning whether the approach traditionally taken in the jurisdictions from where the contract originates is correct.

'One of Lexology's best read publications by in-house counsel'

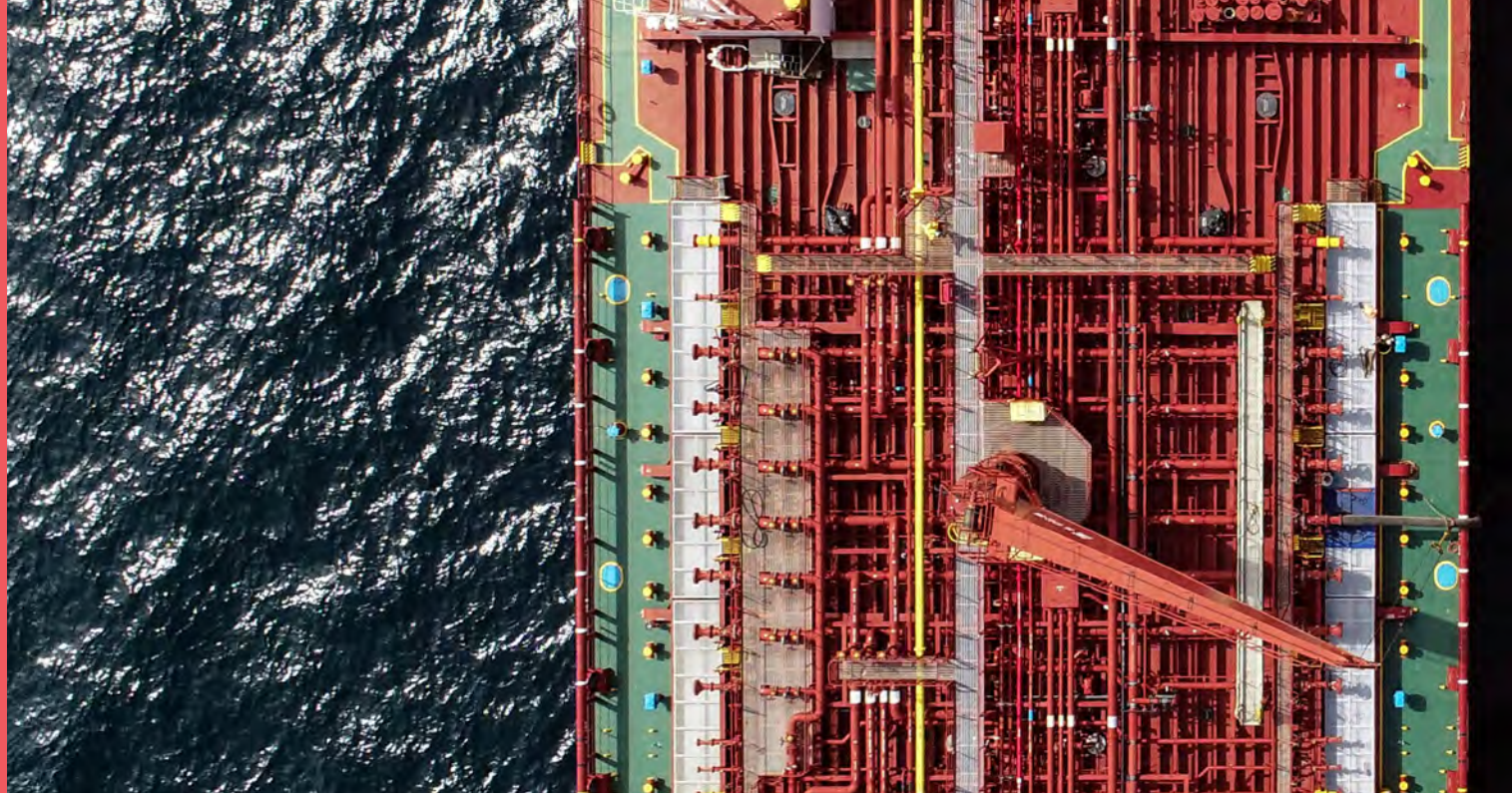
Against this background, the clear message for all working in the sector is that care must be taken in the approach to the exclusion or inclusion of consequential loss as a part of the risk make-up of the contract in question. Further, when using the words 'consequential loss' it is critical to understand how this might be impacted by the choice of governing law.

To assist practitioners in this sector, the CMS Expert Guide to Consequential Loss provides a summary of the approach to consequential loss in 39 jurisdictions and outlines key trends in this area. The guide answers questions such as:

- Do the words 'consequential loss' have a given meaning in law?
- Are the words 'consequential loss' used in contractual exclusion of liability clauses?
- If so, what meaning is attributed to the words 'consequential loss' in contractual exclusion clauses?
- Where a clause includes other heads of loss alongside 'consequential loss', how will the law approach such clauses?
- Do consequential loss exclusion clauses have an impact on non-damages claims?

Access the guide here:

cms.law/en/int/expert-guides/cms-guide-to-consequential-loss-clauses-in-the-energy-sector



COVID-19: Right to designate a force majeure event must be exercised rationally and in good faith

In *Dwyer (UK Franchising) Ltd v Fredbar Ltd* [2021] EWHC1218 (Ch), the High Court gave guidance on the proper approach to interpreting a force majeure clause where the contract provided for one of the parties to designate whether a force majeure has occurred. Although it is not an oil and gas sector case, the decision of the Court gives an important insight into drafting and interpreting force majeure clauses. It also gives an important insight as to the contractual effect of drafting clauses that permit one party to designate the contractual effect of a state of affairs that arises post-contract.

Facts

Fredbar was a small plumbing business that held a plumbing and drain repair services franchise from Dwyer. The franchise agreement provided that the franchise arrangement would be suspended if the parties were prevented or hindered from carrying out their obligations *'by any cause which the Franchisor designates as force majeure'*.

During the coronavirus pandemic, Fredbar's owner was medically advised to self-isolate at home in order to shield his young son, who was clinically vulnerable. Nevertheless, Dwyer refused to designate a force majeure event. Fredbar claimed that this was a fundamental breach of an implied duty to exercise its discretion rationally, entitling Fredbar to terminate the agreement.

Amongst other disputed issues, Dwyer denied the existence of the implied duty, claimed that it was Fredbar that was in repudiatory breach of the agreement, and sought an injunction to prevent Fredbar from setting up a new business in competition with it.

Decision

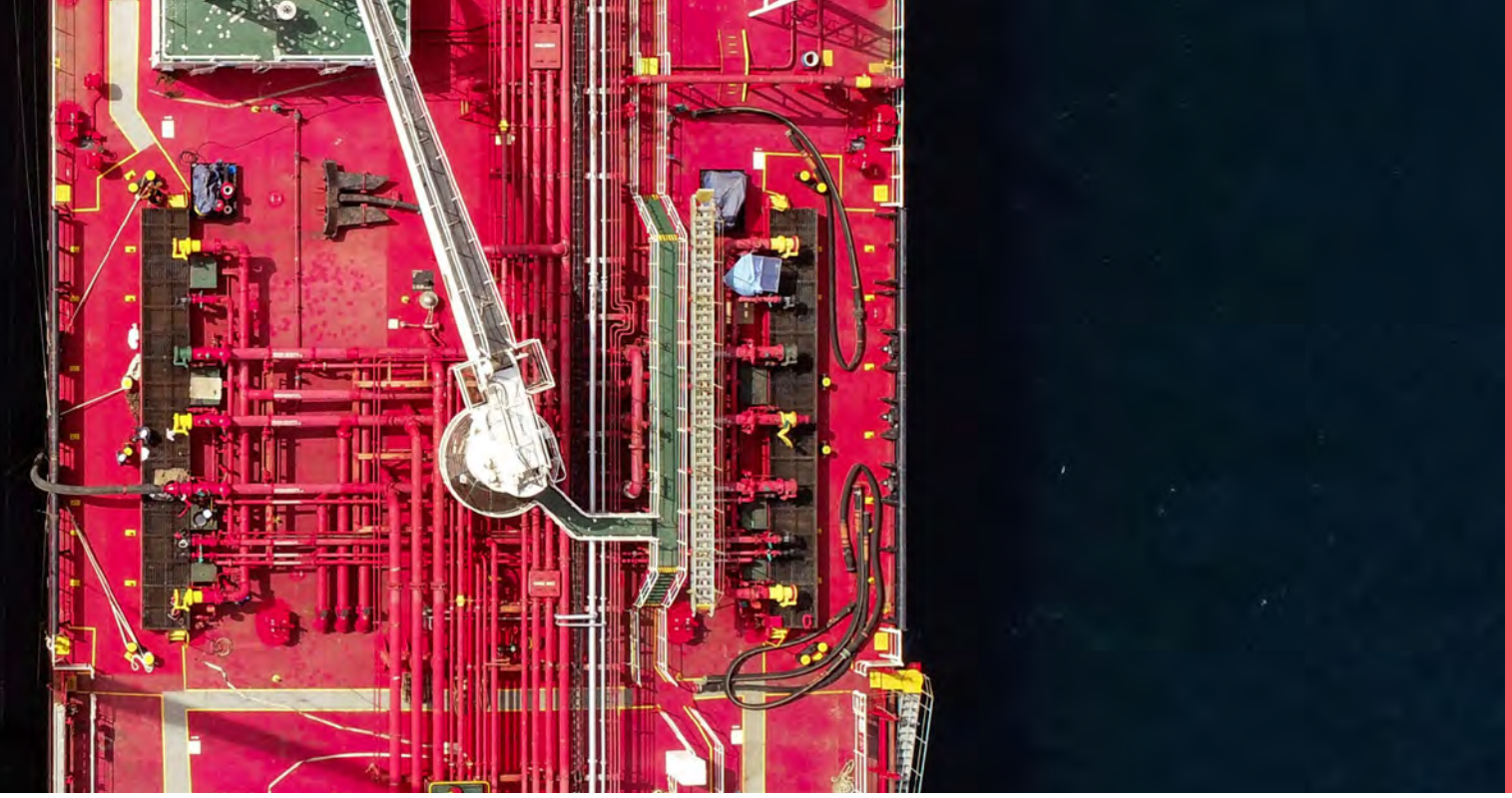
The High Court considered that there was an implied duty of rationality under the principles established in *Braganza v BP Shipping Ltd* [2015] UKSC 17. This meant that:

— Dwyer had to exercise its discretion honestly, in good faith and genuinely;

— It could not exercise the discretion arbitrarily, capriciously, perversely or irrationally; and

— It had to take into account all relevant matters and avoid taking into account irrelevant ones.

The High Court found that in the circumstances, Dwyer should have taken into account that Fredbar was a small business whose ability to service its customers was significantly disrupted by its owner's need to self-isolate. In fact, the High Court noted that for some time, Dwyer failed even to acknowledge that need in correspondence. By failing to do so, it had failed to take into account all relevant matters and had acted irrationally. It was therefore in breach of the implied *Braganza* duty, and Fredbar was entitled in principle to terminate the franchise agreement.



In the event, the High Court held that Fredbar had subsequently affirmed the agreement and lost the right to terminate by reaching an informal agreement with Dwyer that allowed Fredbar's owner to self-isolate without the contractual consequences of declaring a force majeure event. Fredbar's purported termination was therefore a repudiatory breach, although the injunction to prevent Fredbar from setting up a competing business was refused because the judge considered that the restraint of trade clauses in the franchise agreement were too wide to be enforced. However, this aspect of the decision does not detract from the High Court's finding that the *Braganza* duty applied.

Comment

This case is of interest because it is one of the first cases to consider how the usual principles of force majeure apply in the circumstances created by the COVID-19 pandemic. The judgment does not set out any detail as to the judge's reasoning in concluding that a *Braganza* duty of good faith was implied.

In *Braganza* a contract of employment provided that death in service benefit would not be payable if *'in the opinion of the Company'* the death occurred because of the employee's wilful act. The question was whether on the evidence the company was entitled to conclude that the employee had committed suicide. The Supreme Court considered that the employer was entrusted with making a decision which has serious consequences for the family of a deceased employee. There was no reason why the employer should not approach that decision in the same way that any other decision-maker should do. Unless it was possible to impose an objective test of reasonableness *'… the principles to be applied were the same as those applied in public law cases, i.e. not only that the decision is made rationally and in good faith, but also that it is made consistently with its contractual purpose and, we add, that all relevant matters have been taken into account and irrelevant matters not taken into account'.* As such, where a contract designates that one of the parties is unilaterally entitled to determine a state of affairs, English law will usually impose an implied term that the exercise of that power must comply with the protections imposed in public law cases.

As such, where a contractual force majeure clause requires that the existence of an event giving rise to force majeure, or whether a force majeure clause is triggered, should be designated by one party the law may impose an implied term as to the carrying out of the decision-making exercise. Therefore, any party that is faced with a decision in the future as to whether or not to designate a force majeure event should take care that it takes into account the need to comply with obligations implied by law, and should ensure that those factors are recorded in contemporaneous documents.

Judge: Jones J.

Chapter 2

M&A and Tax

Since last year's Annual Review there have been a significant number of cases relevant to oil and gas M&A deals and taxation. Not all relate to oil and gas deals, but are of significant relevance to those involved in buying and/or selling oil and gas companies, or assets:

— In *R (on the application of Thornton) v OGA* [2020] EWHC 2615 (Admin) the Administrative Court considered the Oil and Gas Authority's obligations in giving letters of comfort.

— In *Hurricane Energy plc* [2021] EWHC 1759 (Ch) the High Court rejected a restructuring plan opposed by the shareholders of an oil company where future revenue was uncertain due to the volatile commodity process.

— In *Primus International Holding Company v Triumph Controls – UK Limited* [2020] EWCA Civ 1228 the Court of Appeal decided on the meaning of 'goodwill' in a sale and purchase agreement.

— In *Charles Lim Teng Siang v Hong Choon Hau* [2021] SGCA 43 the Singapore Court of Appeal refused to follow English law on the meaning and effect of a no oral modification clause.

— In *Dodika Ltd & others v United Luck Group Holdings Ltd* [2021] EWCA (Civ) 638 the Court of Appeal decided that a requirement for 'reasonable detail' in a warranty notice provision meant that facts known to both of the parties need not be included.

— In *Travelport & Ors v WEX Inc; Olding & Ors v WEX Inc* [2020] EWHC 2670 (Comm) the Commercial Court considered the first COVID-related Material Adverse Effect dispute to come before English courts.

— In *Total E&P North Sea UK Limited (formerly Maersk Oil North Sea UK Limited) and Total Oil UK limited (formerly Maersk Oil UK Limited) v HMRC* [2020] EWCA Civ 1419 the Court of Appeal considered the requirement for a '*just and reasonable*' apportionment of profit between accounting periods for the purposes of the supplementary charge applicable to profits arising from UK oil and gas activities.

Court of Appeal confirms the meaning of 'goodwill' in share purchase agreements

In *Primus International Holding Company v Triumph Controls – UK Limited* [2020] EWCA Civ 1228 the Court of Appeal gave a significant decision about the meaning of 'goodwill' in the context of analysing an exclusion of liability clause in a contract for the sale of a business. Rather than adopting the definition of goodwill used by accountants, the Court of Appeal confirmed that the concept should be given its ordinary or commercial meaning in such a contract – just like any other term. In this instance, the Court of Appeal concluded that 'goodwill' was '*a proprietary right representing the reputation, good name and connections of a business*'.

Facts

In 2013, the parties entered into a share purchase agreement ('**SPA**') documenting the sale to Triumph Controls – UK Limited ('**Triumph**'), a defence services provider based in Pennsylvania, USA, of two aerospace manufacturing companies owned by Primus International Holding Company ('**Primus**'), a multinational manufacturer of complex metal components.

The purchase price was approximately USD 76.5m. When the companies were sold, they were making a loss but Primus' financial forecasts for the companies to 2017 – which the parties discussed in some detail before agreeing the sale – predicted that the companies would be profitable within a few years.

As 2013 went on, Triumph discovered serious operational and business problems with the companies. After significant efforts to turn the businesses around, including the injection of approximately USD 85m, the companies were approximately USD 120m in debt and Triumph viewed the shares it had purchased as '*worthless*'.

Triumph issued proceedings in 2015, claiming damages for, amongst other things, breach of the following warranty in the SPA:

'19.5 So far as the Sellers are aware, the forward-looking projections relating to the Companies have been honestly and carefully prepared. ('**Warranty**')'

In response to this claim, Primus relied on the following exclusion clause which appeared in a schedule of the SPA:

'3.1 No Claim, claim under the Tax Warranties or, where specifically referenced, an Indemnity Claim, shall be admissible and the Sellers shall not be liable in respect thereof to the extent that…

(f) The matter to which the claim relates:

Is in respect of lost goodwill… ('**Exclusion Clause**')'

Technology and Construction Court Decision

The Technology and Construction Court found that Primus had breached the Warranty by providing Triumph with financial forecasts containing forward-looking projections that were not '*honestly and carefully prepared*'. It rejected Primus' argument that it was not

liable to Triumph because the claim fell within the Exclusion Clause. The Technology and Construction Court held that the ordinary meaning of 'goodwill' is '*business reputation*' and that the losses Triumph had suffered because of Primus' breach were not '*lost goodwill*'.

The Commercial Court calculated that, but for that breach, the purchase price that Triumph paid under the SPA would have been approximately USD 5.7m lower to reflect the reduction in the forecasted performance of the companies. After subtracting a deductible provided for in the SPA from that amount, it awarded Triumph damages of approximately USD 4.2m.

Court of Appeal Decision

The Court of Appeal (Henderson, Coulson and Carr LLJ) agreed with the decision at first instance and dismissed Primus' appeal.

In doing so, the Court of Appeal had to consider two competing definitions of 'goodwill'. Triumph argued that 'goodwill' as used in the Exclusion Clause should be given its ordinary commercial meaning, being '*the good name, business reputation and connections of a business*'. Primus argued that the proper meaning of 'goodwill' was '*a loss of share value, where that value represents the difference between the cost of acquisition and the fair value of its identifiable net assets and/or where that loss of share value is caused by the impairment of the value of non-identifiable assets*'. Primus' definition was an accountants' one and Primus referred to a paper prepared by PwC to support its argument.

The Court of Appeal preferred the ordinary commercial meaning over the accounting definition for four reasons.

1. **Ordinary legal meaning.** When construing the Exclusion Clause, the Court of Appeal did not need to go beyond the actual words used as read in the context of the SPA as a whole. The Court of Appeal referred to multiple sources that established that the '*ordinary legal meaning*' of 'goodwill' was the meaning contended for by Triumph. There was no reason for the Court of Appeal to depart from the ordinary legal meaning here.

2. **Authorities.** The applicable case law, stretching back to *Austen v Boys* (1858) 2 De G & J 626, confirmed that the courts have long given 'goodwill' the meaning that Triumph contended for rather than the accounting definition.

3. **Use of the concept elsewhere in the SPA.** Where 'goodwill' was used in other parts of the SPA, it was clearly being used in the sense contended for by Triumph, rather than in the accounting sense. For example, Clause 1.1 defined 'Intellectual Property' to include '*rights to goodwill*' and Clause 13, titled 'Protection of Goodwill' contained detailed undertakings not to employ certain named employees for two years after the sale which suggested that 'goodwill' was a broader concept than merely something on a balance sheet at the time of the sale.

4. **Nature of the claim.** The nature of Triumph's claim was a claim for overpayment as a result of careless financial forecasts. This was entirely different from a claim for loss of reputation, good name or business connections. Moreover, if the Exclusion Clause was construed using the accounting definition, it would have extended to all claims in respect of parts of the purchase price not covered by the value of the net assets of the companies at the time of sale. This would have the result that the Warranty would have no work to do at all, as it would be almost inevitable that breaches of the Warranty would not relate to the net value of assets at the time of sale but to overly optimistic promises about future value.

Comment

Although not an oil and gas case, the decision of the Court of Appeal has obvious relevance and application to oil and gas M&A deals. The Court of Appeal has confirmed that typically (but subject always to the context of the contract in question) the meaning of 'goodwill' when used without further explanation in an SPA is the good name, business reputation and connections of a business. The Courts will not generally ascribe to 'goodwill' its technical accounting definition unless there is good reason for departing from its ordinary legal meaning.

The importance of documenting agreements, including definitions, carefully cannot be overstated. As the Court of Appeal stated: *'If a contract contains a term to which the parties intend to give an unusual or technical or non-legal meaning, that must be spelt out'.*

Judges:
Technology and Construction Court: O'Farrell J.
Court of Appeal: Henderson LJ, Coulson LJ and Carr LJ.

OGA's role in M&A transactions – letters of comfort and judicial review

In *R (on the application of Thornton) v OGA* [2020] EWHC 2615 (Admin) the Administrative courts considered, for the first time, whether a 'letter of comfort' given by the Oil and Gas Authority ('**OGA**') concerning a change of control should be overturned. Although the application was unsuccessful, the decision provides insight into (i) the OGA's process in considering a request for a letter of comfort; and (ii) the grounds upon which the OGA's decision to give such a letter may be challenged. As the facts concerned the financial covenant of a new entrant to meet decommissioning liabilities, it will be of significant interest to the industry.

Facts

Third Energy UK Gas Limited ('**Third Energy Gas**') is licensee under a licence granted under the Petroleum (Production) Act 1934, to search, bore for and get petroleum (defined to include natural gas) in Yorkshire (the '**Licence**'). It is a subsidiary of Third Energy Onshore ('**Third Energy Onshore**'), which is in turn owned by Third Energy Holdings Limited ('**Third Energy Holdings**'). Subsidiaries of the Barclays banking group were the primary investors in Third Energy Holdings.

The Claimant ('**Mr Thornton**') is a member of the public, living in North Yorkshire. The Defendant, OGA is empowered by statute to regulate, influence and promote the UK oil and gas industry in order to maximise the economic recovery of the UK's oil and gas resources.

A Deed of Variation in 2018 amended the Licence to incorporate Model Clauses 1-44 set out in Schedule 2 to the Petroleum Licensing (Exploration and Production) (Landward Areas) Regulations 2014. Amongst other things, Model Clause 41(3) gave the OGA certain powers, including to revoke the Licence or require a further change of control, in the event of a change in the control of the licensee.

On 25 April 2019, Third Energy Group announced that it had agreed to sell Third Energy Onshore to York Energy (UK) Holdings Limited (the '**Buyer**') *'subject to satisfaction of agreed conditions precedent, including regulatory review'* (the '**Transaction**'). One such condition precedent was that a letter of comfort be received from the OGA confirming that it would not exercise its powers in response to the change of control that would result from the Transaction.

The OGA undertook an internal review of the question whether to issue the letter of comfort. The review's conclusions were submitted on 3 July 2019 to the OGA's Director of Regulation, Mr Tom Wheeler (the '**OGA Internal Submission**'). He agreed with the

recommendation made in it, noting all of the risks identified therein, and decided that a letter of comfort should be sent, concluding *'that this is the course that provides the greatest probability of those commitments being discharged by the Licensee'.*

The Claimant was concerned that the Buyer would not have the financial ability to meet its acquired licence commitments, which included proper decommissioning of gas wells, and instead taxpayers would have to meet the financial liabilities. The Claimant was aware that in other countries fracking companies were becoming insolvent and taxpayers were picking up the costs for decommissioning and clean-up. As a result, in October 2019, the Claimant sought permission to bring a judicial review, claiming the OGA had failed to carry out adequate financial assessments of the companies involved in the sale. The Claimant asserted in particular that the OGA did not properly consider the risk that the sale could leave the taxpayer paying decommissioning and clean-up costs if the target company became insolvent.

Decision

In summary, the Administrative Court considered that, taking account of the Petroleum Act 1998 and related regulations (and in particular, the applicable Model Clauses), the OGA had properly considered the risks identified by the Claimant. Permission to bring a judicial review application was refused.

Three main issues were:

1. Whether the OGA misinterpreted the terms of Model Clauses 40 and 41

The Claimant argued that the OGA had misinterpreted Model Clauses 40 ('Restrictions on assignments etc') and 41 ('Power of revocation') and their interaction with each other. In particular, the Claimant asserted that the two should be read together so that Model Clause 40, restricting assignment, was wide enough to cover a change of control and was not limited to instances of licence assignment. Read together, the Claimant argued the Model Clauses mean that a change of control of a licensee requires the prior written consent of the OGA. As such, the OGA's written consent should have been obtained to the Transaction.

The Administrative Court did not consider this argument to be well founded. The wording of the Model Clauses is clear. Model Clause 40 is concerned with what a licensee does or causes to happen. Model Clause 40 does not apply to circumstances where there is no action by the licensee to restrict, such as a change of control of a licensee on acquisition of that licensee (or its parent company), which *'does not involve the licensee doing anything'.* Conversely, Model Clause 41(3) regulates change of control of a licensee and is concerned with what happens to the licensee as opposed to actions by the licensee. The relevant provision was Model Clause 41 and prior written consent of the OGA to the Transaction was not required.

2. Whether the OGA, in issuing its letter of comfort, had failed to assess the financial capability of both parties to the sale

The Claimant's challenge asserted that the OGA should have (but had not) followed its own policies set out in its Financial Guidance. At paragraph 3.9, the Financial Guidance describes that, where an existing licensee intends to retain a commitment after the completion of the transaction, the OGA will *'consider the financial capability of both parties to the transaction…'* to *'seek to ensure the transaction is not detrimental to either the new and existing licensee's capacity to meet their Commitments in their post-completion portfolios'.* The focus of the contention was that the OGA should have examined the financial capability of Third Energy Gas absent the sale against such capacity once the sale was completed. A seller 'backed' by Barclays was to be replaced with the Buyer that was a subsidiary of a Cayman Islands company *'with no reputation to lose'.*

The Claimant considered that the OGA had failed to comply with this requirement by considering only the Buyer's financial capability and not also that of Third Energy Gas and its parents, Third Energy Onshore and Third Energy Holdings. Amongst other things, the Claimant drew attention to the fact that the Buyer had no accounts filed with Companies House, meaning there was no publicly available information as to its ability to cope with the acquired liabilities and work commitments of Third Energy Gas. In addition, the debt write-off and cash injection by Barclays shortly before the Transaction improved Third Energy Onshore's financial health such that other potential buyers might have been interested in acquiring control of Third Energy Onshore.

However, the OGA's internal considerations showed that:

— The OGA had relied upon its own Financial Guidance and the financial capability of both parties was indeed considered.

— Third Energy Onshore had cut operational staff '*to the bare bones*' and Barclays might be unwilling to continue funding and, without that funding, insolvency might follow.

— The sale effectively released security in place for the decommissioning of Third Energy Gas's installations and wellbores.

As such the Administrative Court considered that OGA did give sufficient consideration to the financial capability of both parties prior to issuing the letter of comfort. The OGA considered that whilst there were risks associated with the change of control, the risks would have been greater had the sale not occurred.

In relation to the scope of enquiry required by the OGA, the Administrative Court decided that *'It is obvious that the consideration or assessment needed will depend on the case. In the present case it is questionable what a fuller financial capability assessment of Third Energy Onshore or Third Energy Holdings in the absence of the sale would have added to the fundamentals that were considered'.*

In respect of the Buyer, the Claimant averred that no proper investigation of financial capability had taken place. However, the Administrative Court concluded that the OGA was fully aware of the risk that it may not be able to meet its commitments. Further, the Financial Guidance suggests that *'more importance'* might be placed on financial capacity than financial viability in the case of a newly-incorporated applicant. In such cases, the OGA would *'consider in detail the identity and track record of the shareholders, directors and officers'.* This it had done.

3. Whether the OGA had failed to take into account the serious risk that the change of control would lead to the Subsidiary Licensee being unable to pay for its decommissioning costs

When discharging its functions, including making its decision in relation to the requested letter of comfort, the OGA is required to have regard to *'the need to minimise public expenditure relating to, or arising from, relevant activities'* where relevant activities are defined as *'any activity in relation to which the OGA has functions'* (section 8 of the Energy Act 2016). The Claimant argued that the OGA failed to comply with this duty by failing to assess whether Third Energy Gas had the financial capability to discharge its decommissioning obligations imposed by Model Clause 20 and to consider any risk of decommissioning being carried out at public expense. Model Clause 20 imposes a number of obligations on licensees in relation to the plugging and abandonment of wells, including an obligation to plug wells in accordance with a specification approved by the OGA.

The evidence before the Administrative Court confirmed that the OGA had identified a foreseeable risk that Third Energy Gas would be unable to pay its decommissioning costs following the sale and considered this risk in particular when deciding whether or not to provide the letter of comfort. It had taken steps to raise this issue with BEIS, the department directly in charge of ensuring that decommissioning programmes are approved and carried out, but also had in mind other factors (including the potential risk that decommissioning costs could not be met by Third Energy Gas if the sale did not go ahead). Therefore, the Administrative Court concluded that the OGA had not failed to have regard to the need to minimise public expenditure as it had focused on this when making its decision to issue the letter of comfort.

Comment

The terms for acquisition of an oil and gas company with assets in the United Kingdom will usually include as a condition precedent for completion of the sale that a letter of comfort is obtained from the OGA, confirming that it is not minded to exercise its statutory powers to revoke any of the relevant licences nor seek further changes of control. Although commonly sought (and granted), there has been relatively little judicial consideration of the process and approach taken in that regard. *R (on the application of Thornton) v OGA* [2020] EWHC 2615 (Admin) is therefore of particular interest to those involved in such transactions.

Although challenging a letter of comfort might be one route for a third party seeking to prevent a change of control from proceeding:

1. As the Commercial Court observed in *TAQA et al v RockRose* [2020] EWHC 58 (Comm) in relation to financial assessments by the OGA in deciding whether to give a letter of comfort: *'The OGA's financial assessment is for its purposes not those of third parties as its own guidance material makes clear and the OGA were aware of what Mr. Lewis called the 'firewall' – that is the obligation of the remaining participants to bear the obligations of a failed participant. That might have been a comfort for the OGA but was the source of the concern about RR's financial stability so far as the claimants were concerned'.* As such, the scope of the OGA's necessary enquiry is limited to protecting the interests identified in the OGA guidance and not those of joint venture partners or other third parties.

2. In relation to the scope of enquiry required by the OGA in respect of the interests covered by its own guidance, the Administrative Court decided that *'It is obvious that the consideration or assessment needed will depend on the case'.* As such, there appears to be no pre-defined scope of enquiry that the OGA must undertake before issuing a letter of comfort, making it difficult to argue that a mere failure to give consideration to a particular fact or issue automatically opens up a route to challenge.

3. The mere lack of financial covenant of the buyer, or its parent, may be insufficient to challenge a letter of comfort provided that proper consideration has been given to that lack of financial covenant by the OGA.

4. In the case of new entrants, the Administrative Court appears to have accepted that the OGA acts properly when judging financial covenant if it follows its financial guidance, which suggests that *'more importance'* might be placed on financial capacity than financial viability. In such cases, the OGA should *'consider in detail the identity and track record of the shareholders, directors and officers'.*

Judge: Knowles J.

High Court declines to sanction Restructuring Plan

In *Hurricane Energy plc* [2021] EWHC 1759 (Ch) the High Court declined to approve the cross-class cram down of Hurricane's shareholders as part of the Part 26A restructuring plan because the available evidence did not demonstrate that the shareholders were '*no worse off*' as a result of the restructuring plan. On that basis the restructuring plan failed.

Facts

A Part 26A restructuring plan is a procedure under the Companies Act 2006 introduced by the Corporate Insolvency and Governance Act 2020. As a condition to entry for a restructuring plan, a company must be in financial difficulties and the plan be designed to mitigate or reduce those financial difficulties. The company's creditors and, where relevant, members vote as classes dependent on their rights in relation to the company proposing the plan. The Court has the power to sanction a restructuring plan even where classes of creditor voting against provided that (a) at least one class with an economic interest votes in favour and (b) the other classes are '*no worse off*' as a result of the restructuring plan than they would be in the '*relevant alternative*'.

Hurricane Energy plc ('**Hurricane**') is an AIM-listed company with a number of subsidiaries holding licences in the UKCS in relation to a number of fields (Lancaster, Lincoln, Warwick and Halifax). The terms of the licences expire on or before December 2024.

Hurricane's principal creditors are unsecured bondholders with debt of USD 230m (the '**Bondholders**' and the '**Bonds**'). While Hurricane has been paying the Bondholders current (as to interest) it predicted that it would not be able to repay the principal on maturity on 24 June 2022. Hurricane is holding USD 168.5m in cash, of which at least USD 100m is unrestricted.

Hurricane proposed a restructuring plan. The purpose of the restructuring plan was to extend the maturity date for the Bonds, reduce the principal amount, increase the coupon and provide security to support the Bonds.

Additionally, Hurricane would issue the Bondholders with shares which would provide them with 95 percent of the equity in Hurricane.

Hurricane proposed that only the Bondholders would vote on the restructuring plan, on the basis that it was not necessary for the shareholders to vote, as their rights were unaffected. A number of shareholders objected to the restructuring plan. At the convening hearing (the first court hearing), the High Court determined that the shareholders should be entitled to vote on the restructuring plan.

At the plan meetings, 100 percent of the Bondholders voted in favour and 92.34 percent of shareholders voted against. Consequently, Hurricane asked the High Court to exercise its powers of cross-class cram down in order to sanction the plan.

Decision

Refusal to exercise cross-class cram down

The High Court had to consider: (a) what would be most likely to happen in relation to Hurricane were the plan not sanctioned; (b) what would be the consequence of that for shareholders; and (c) what would be the outcome if the plan is sanctioned.

The High Court considered a controlled wind-down of Hurricane to be the '*relevant alternative*'. In this scenario, Hurricane would continue to operate and receive revenues from its subsidiaries. How much money was generated in this scenario was dependent on the production levels from one of its wells (P6) and the future price of oil.

Hurricane's argument was that future revenues to May 2022 (ahead of the Bond maturity date) would be insufficient to repay the Bonds in full and consequently, in the '*relevant alternative*' the shareholders would receive nothing. The shareholders argued that this was too blinkered a view and that actual well performance, production post May 2022, future oil price, the potential for refinancing or a bond buyback could all make a difference to the eventual outcome. The High Court was also unconvinced that the FPSO needed for the fields would be unavailable unless the restructuring plan were approved. Additionally, shareholders pointed to the fact that there was no '*insolvency crisis*' and irrevocably removing shareholders' rights at this stage was premature.

It was accepted that the restructuring plan return to shareholders was very small: a small potential surplus of which they would receive 5 percent. Consequently, the High Court considered whether shareholders would be better off with that nominal return or with the uncertain but potentially better outcome if the restructuring plan were not approved. His conclusion was that the shareholders retaining 100 percent of the equity in Hurricane and continuing to trade, with a realistic prospect of repaying the Bonds in full was a better position that receiving 5 percent of the equity with no prospect of anything but a minimal return.

On that basis, one of the conditions for a cross-class cram down was not met and consequently the restructuring plan could not be approved. In any event, the High Court would not exercise its discretion to sanction the restructuring plan.

Position of the board and urgency

Hurricane had presented the restructuring plan as being urgent for a number of reasons but principally that the shareholders were taking steps to hold a shareholders' meeting to remove the current board. It was anticipated that the board would be removed on 5 July 2021 and that the replacement board would withdraw the restructuring plan. The new board would be likely to pursue a different 'risky' strategy that, the bondholders argued, would result in a lower repayment of the Bonds.

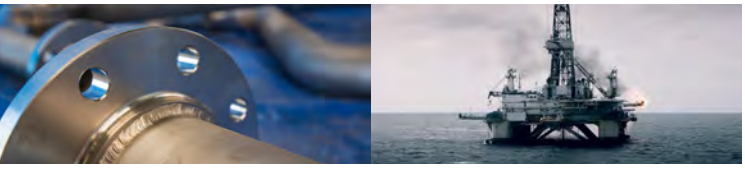
The High Court's view was that the imminent removal of the board was not a reason for urgency. The shareholders were within their rights to remove and replace the board and the new directors would be subject to directors' duties in the usual way. There were no other grounds to consider that it was essential that the Bonds be restructured now.

Comment

Hurricane is an interesting case as it shows the risks in seeking a restructuring too far ahead of the date on which an '*insolvency crisis*' could arise. Fundamentally, the High Court was not convinced that, in a volatile market such as oil and gas, changes in production and pricing might not improve the shareholders' position. Absent the threat of an immediate insolvency, it was reasonable for the shareholders to take a view on future prospects and wish to hold their position. It is also a useful reminder of the shareholders' rights to have a board of their choice, even if those board members will owe duties to creditors due to the company's financial position.

It is unclear as to whether Hurricane will appeal the decision.

Judge: Zacaroli J.



Singapore Court of Appeal declines to follow Rock Advertising: endorses more liberal approach to NOM clauses

In *Charles Lim Teng Siang v Hong Choon Hau* [2021] SGCA 43 the Court of Appeal in Singapore has considered the legal effect of no oral modification clauses ('**NOM clauses**') under Singaporean law. In a break with the position in the UK (decided in the *Rock Advertising Limited v MWB Business Exchange Centres Limited* [2018] 4 All ER 21 case), the Court of Appeal held that NOM clauses merely raise a rebuttable presumption that in the absence of an agreement in writing, there would be no variation. Given the prevalence of such clauses in commercial contracts, this divergence between the English and Singaporean laws may have a significant impact on parties' choice of governing laws of their contracts.

Facts

Mr Lim and others (the '**Sellers**'), entered into a sale and purchase agreement ('**SPA**') with Mr Hong and Mr Tan (the '**Buyers**'), pursuant to which the Sellers were to sell 35 million shares in a public listed company to the Buyers for SGD 10.5m.

The SPA provided for a completion date of 17 October 2014 ('**Completion Date**') and that time would be of the essence. It also contained a NOM clause which provided that *'No variation, supplement, deletion or replacement of any term of the SPA shall be effective unless made in writing and signed by or on behalf of each party'* ('**SPA NOM Clause**').

Over 3 years had passed after the Completion Date before the Sellers' solicitors issued a letter to the Buyers, demanding compliance with the SPA and threatening legal action. The Sellers subsequently commenced action in the High Court of Singapore, claiming damages for breach of the SPA due to the Buyer's failure to complete.

The Buyers denied being in breach of the SPA and amongst other things, claimed that pursuant to an alleged telephone call between Mr Lim and Mr Hong on or about 31 October 2014, the SPA was rescinded by mutual agreement. The High Court accepted the Buyer's evidence in this regard and rejected the Seller's claim.

On appeal to the Court of Appeal of Singapore, the Sellers raised, among other things, a new argument that the alleged oral rescission, even if proved, was invalid because the requirements of the SPA NOM Clause had not been satisfied. The Buyers argued that the SPA NOM Clause did not apply to rescission and could not in any event invalidate an oral agreement contrary to its terms which had been adequately proved.

Decision

NOM clause not applicable to recission agreements
The Court of Appeal decided that, based on its plain language, the SPA NOM Clause did not apply to the rescission of the SPA as it only expressly provided that a '*variation, supplement, deletion and replacement*' must be made in writing. The common denominator underlying these four forms of modifications is that the SPA will continue to remain valid and in force, which is in contrast to the effect of a rescission. The appellants' arguments that a rescission amounted to 'replacing' the SPA with an agreement to rescind, or that it 'deleted' the clauses in the SPA which required performance of the share transaction, and that such deletion led to the rescission of the SPA, were rejected by the Court of Appeal.

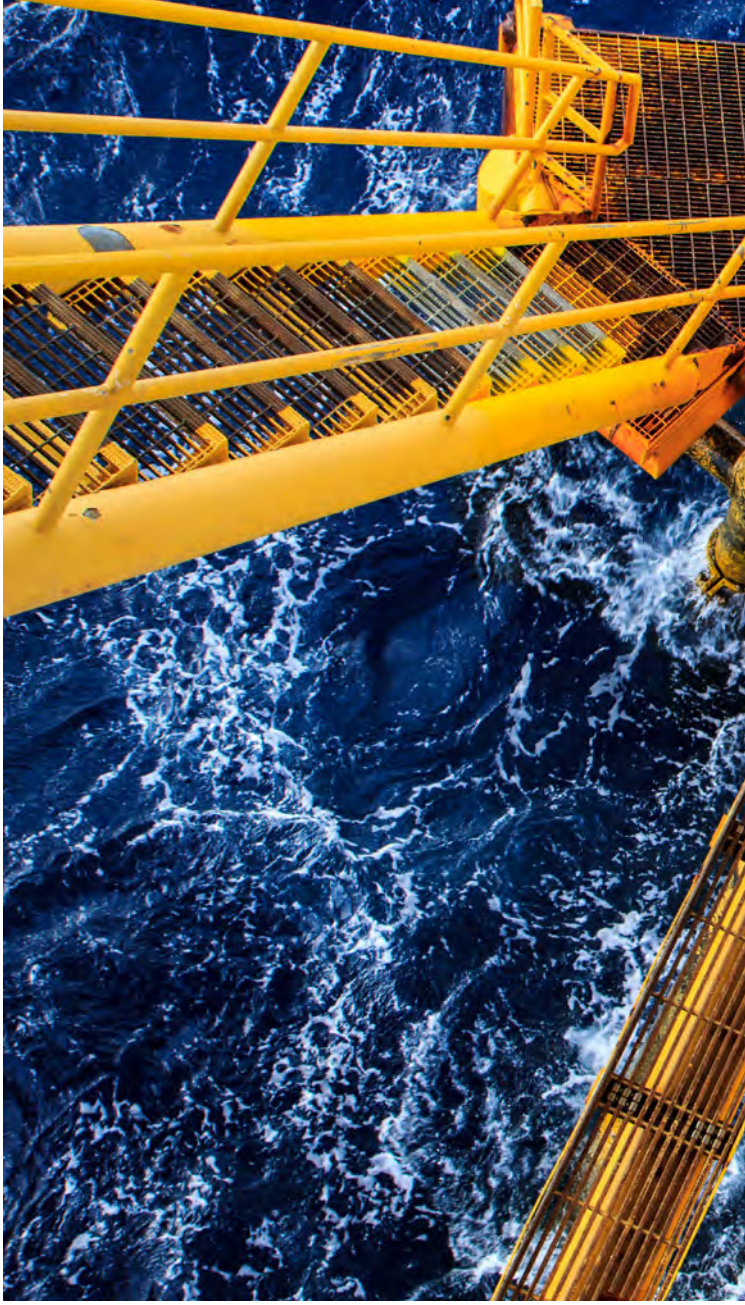
On the facts, the Court of Appeal agreed with the High Court of Singapore that the parties had orally agreed to rescind the SPA via the telephone call on 31 October 2014.

The legal effect of NOM clauses
Even though it was not strictly necessary to do so, the Court of Appeal also proceeded to discuss and clarify the legal effect of NOM clauses in general.

The Court of Appeal examined the current schools of thought in this regard by reference to law from other jurisdictions:

— First, the strict approach taken by the majority of the UK Supreme Court in *Rock Advertising* (delivered by Lord Sumption). Under this approach, any subsequent modification to the contract must comply with the formalities stated in the NOM clause, otherwise it will be deemed invalid. As such, a NOM clause can only be removed by an agreement of the parties which complies with the formalities set out in the NOM clause.

— Second, the approach developed by Briggs LJ in *Rock Advertising*. Under this approach, the parties' oral agreement specifically to depart from a NOM clause will be treated as valid. Such oral agreement may be express or by necessary implication. However, in situations where an oral variation is made without express reference to the NOM clause, a strict test should be applied before the court finds that parties had, by necessary implication, agreed to depart from the NOM clause.



— Third, the approach endorsed by the Singapore Court of Appeal in *Comfort Management Pte Ltd v OGSP Engineering Pte Ltd.* [2018] 1 SLR 979. Under this approach, a NOM clause merely raises a rebuttable presumption that in the absence of an agreement in writing, there would be no variation. Incidentally, this approach was adopted from the English Court of Appeal's decision in *Rock Advertising* which was later reversed by the UK Supreme Court on appeal.

The Court of Appeal confirmed the third approach, siding with the Court of Appeal in *Rock Advertising* and disagreeing with the two Supreme Court approaches. Underlying this difference is the emphasis the respective courts placed on parties' intentions at the time of entering into a contract. Sumption LJ's view in *Rock Advertising* was to the effect that once parties had agreed to regulate their legal relations, then they are bound by those regulations. Each party's autonomy operates up to the point when the contract is made, but thereafter only to the extent that the contract allows.

On the other hand, the Court of Appeal took the view that fixing parties' intention at the time the contract was entered into overlooks the fact that parties to a contract had the autonomy to change the terms of the contract. In the Court of Appeal's opinion, Sumption LJ view conflated the parties' individual autonomy (which should necessarily be bound by the terms of the contract) with the parties' collective autonomy. Collectively, the parties to a contract should be able to jointly agree to vary any aspect of their own agreement and the Court should uphold their autonomy to do so.

While the Court of Appeal recognised there are several legitimate commercial reasons why parties may choose to included NOM clauses in their contract, those reasons do not provide a legitimate basis to prevent parties from varying a contract orally where such an oral variation can be proved. The Court of Appeal distinguished between proving the fact that an oral variation had taken place (and the evidential difficulties that come with it) and recognising an oral variation at all in cases where there are NOM clauses.

Nevertheless, the Court of Appeal emphasised that compelling and cogent evidence is required before the Court will find and give effect to an oral variation in order to rebut the presumption that there is no oral variation. This does not modify the standard of proof, but rather *'serves to reflect the inherent difficulty in proving such an oral variation in the face of their express agreement to the contrary as prescribed in the NOM clause'*. However, this perceived evidential difficulty in proving the oral variation should not be confused or conflated with the question of the legal effect of a NOM clause.

Once the burden of proof in relation to the oral variation is discharged, the NOM clause will cease to have legal effect because such is the collective decision of both parties to the contract. The test, according to the Court of Appeal, should be whether at the point when parties agreed on the oral variation, they would necessarily have agreed to depart from the NOM clause had they addressed their mind to the question, regardless of whether they had actually considered the question or not.

Although, strictly speaking, the Court of Appeal's decision on these points is obiter, and therefore not binding, the fact that the decision was made by a panel of five judges of Singapore's highest court means that it is very likely to be followed in future cases.

NOM clauses and estoppel

For completeness, the Court of Appeal also observed that even were NOM clauses to have the strict effect found by the UK Supreme Court, the doctrine of equitable estoppel would nevertheless be likely to apply in most cases where an oral agreement had been proved. This was because in most cases such an agreement is likely to be provided by the parties' subsequent conduct in performing the contract as orally varied. Accordingly, *'in most circumstances where an oral variation (which would in itself constitute a clear and unequivocal representation) is proved, the parties should be able to establish detrimental reliance on the oral variation (the act of performing the obligations of the oral variation), and thereby satisfy the doctrine of equitable estoppel'*.

This finding contrasts with a stricter approach to such estoppels indicated by Lord Sumption in *Rock Advertising* and subsequently applied by the English courts. This approach requires more than mere reliance on an oral promise; some statement or conduct is needed which unequivocally represents that the oral variation was valid notwithstanding its non-compliance with the NOM clause.

Comment

NOM clauses are prevalent in oil and gas contracts, included to ensure commercial and legal certainty, and to prevent such situations of having to prove oral modifications. In these circumstances, a party to a contract governed by Singapore law seeking to rely on a NOM clause should ensure that any oral discussions that may have the effect of, and/or be relied upon as, modifying the terms of the underlying contract be properly clarified as not being binding unless documented in accordance with the formalities set out in the NOM clause.

In circumstances where parties are seeking to rely on such oral discussions, the safest approach is still to comply with the NOM clause, but if that is not practical then proper notes and records should be taken. As stated by the Court of Appeal, compelling and cogent evidence is required in order to make a finding that there has been an oral agreement to modify the terms of the contract.

Further, clear policies and guidelines should be established in respect of the day-to-day management and execution of the contract so that daily discussions or off the record conversations do not have the unintended effect of modifying the terms of the contract. Where there has been some form of discussion or communication that has the effect of modifying the terms of the contract, a party that has allowed the other party to rely on this discussion or communication to its detriment could also be estopped from relying on the NOM clause.

The Court of Appeal's decision may also have relevance to the continued development of English law in relation to NOM clauses. While the UK Supreme Court's decision in *Rock Advertising* has authoritatively determined the English position in relation to the legal effect of such clauses, the position in relation to estoppel was addressed only in qualified obiter comments. The Court of Appeal's suggestion in the present case that a more liberal approach might apply than indicated by Sumption LJ could therefore prove relevant in future English law cases.

As NOM clauses appear in many international model forms, the decision of the Court of Appeal is of wide relevance across a variety of sectors. For example:

— The AIPN Model Form Operating Agreement (2012) requires an amendment to be a *'written amendment'* and *'signed'*.

— Clause 74.5 of the BP Oil International Limited General Terms & Conditions for Sales and Purchases of Crude Oil and Oil Products (2015) also require modifications to be *'evidenced in writing'*.

— The NEC suite of contracts requires amendments to be *'in writing and signed by the parties'*.

On a practical front, it should also be remembered that an email, in some jurisdictions, may be 'in writing' for the purposes of a NOM clause. For example, in *C&S Associates UK Ltd v Enterprise Insurance Company plc* [2015] EWHC 3757 (Comm), the English Commercial Court decided that:

— An exchange of emails was *'in writing'* for the purposes of a NOM clause.

— An email with a signature block was able to satisfy the requirement for an agreement to be *'signed'*.

Finally, the wider implication of this divergence between English and Singaporean law (as well as the laws of other jurisdictions) on parties' choice of governing law should not be understated, particularly on multinationals and international parties conducting business globally. When considering alternatives in governing laws, parties should have a proper appreciation of the legal effect of NOM clauses.

Judges: Menon CJ, Phang JCA, Prakash JCA, Chong JCA and Ang JAD.

‘Reasonable detail’ in notice of a warranty claim does not include facts already known to the recipient

In *Dodika Ltd & others v United Luck Group Holdings Ltd* [2021] EWCA (Civ) 638 the Court of Appeal decided that a notice of a claim under a tax warranty in a sale and purchase agreement (‘**SPA**’) did not have to include details of the underlying facts and of the investigation by the tax authorities that were already known to the recipients.

Facts

The buyer under the SPA gave notice to the sellers of a potential claim under the tax warranties in the SPA. The agreement required the notice to provide *‘reasonable detail’* of *‘the matter which gives rise to such Claim’*. It also appointed the former CEO and Deputy CEO of the target company as the sellers’ representatives for any matter arising between the sellers and the buyer.

The notice stated that the claim related to an investigation by the Slovene tax authority into the transfer pricing practices of one of the target company’s subsidiaries during the periods 2013-14 and 2015-17. No other detail was provided as to the substance of the matters under investigation. However, prior to giving notice, the buyer had been keeping the sellers’ representatives informed of the progress of the investigation, and those representatives were involved in strategic discussions in relation to it and had access to relevant documents.

The sellers issued proceedings for a declaration that the notice was invalid and applied for summary judgment on that claim. They argued that the notice should have provided details of the facts underlying the tax investigation that were said to give rise to a potential tax liability which would be recoverable from the sellers under the warranty. The issues that arose were:

— Whether the phrase *‘the matter which gives rise to such Claim’* referred to the investigation or to the underlying facts emerging from it; and

— if it referred to the underlying facts, whether the reference to transfer pricing practices during certain periods constituted *‘reasonable detail’*.

Decision

Matter giving rise to the claim

The Court of Appeal agreed with the Commercial Court, at first instance, that the reference to *‘the matter giving rise to the Claim’* meant the underlying facts, events or circumstances and not just the fact of the tax investigation itself. That arose from an analysis of how ‘Claim’ was

defined, and of what the buyer would have had to plead, were it to bring such a claim before the Court.

Reasonable detail

The Commercial Court had concluded at first instance that the phrase *'reasonable detail'* required the buyer to identify which particular features of the company's transfer pricing practices were alleged to give rise to a potential tax liability.

However, the Court of Appeal decided that the reasonableness qualification meant that the buyers did not have to include details of which the sellers' representatives were already aware. Since they were aware from their earlier communications with the buyers that the investigation focused on allegations that intra-group prices charged by the company during the relevant periods had been unduly low, and knew how those prices had been calculated, it was not necessary for that information to be repeated in the notice.

The Court of Appeal also took into account that the tax authority had not shared with the buyer which specific transactions it was concerned about, or on what basis it considered that the company's role in those transactions might not have been correctly described for the purposes of claiming tax reductions. There was therefore limited further detail the buyer could have provided, most of which was already known to the sellers and which would have added no commercial benefit. The Court of Appeal considered:

'What is reasonable takes its colour from the commercial purpose of the clause, and what businessmen in the position of the parties would treat as reasonable. Businessmen would not expect or require further detail which served no commercial purpose. That would be the antithesis of what is reasonable'.

The Court of Appeal held that the purpose of the notice clause was to enable the sellers to make such inquiries as they were able, and in this case they accepted that additional detail would not have furthered that purpose.

Comment

While the conclusions reached by the Court of Appeal were based on the specific drafting used in the SPA, that wording does not appear to have had any particularly unusual features. Although the case does not relate to oil and gas, sale and purchase agreements in the industry regularly include similar clauses. Indeed, the requirement to give reasonable detail about the matter (or matters) giving rise to a claim is commonly found in notices of claim provisions. To mitigate the risk of any such notice being declared invalid, it remains the case that potential claimants should ensure they comply fully with any notice requirements. It would be prudent to assume that a notice under a warranty provision should provide details of the underlying facts, and not just of any third party claim or investigation that may have prompted the notice.

That said, English law will be reluctant to require a party to provide details that add no benefit to the recipient, unless those details are unambiguously called for in the wording of the notice requirement. Parties in receipt of such a notice should consider carefully whether the prospects of a successful challenge to the validity of the notice are sufficient to justify risking the additional costs and time involved, instead of engaging with the substance of the matters notified.

The case also serves as a useful reminder to buyers and their advisers of the importance of negotiating precisely what ought to be included in a valid notice of claim, thereby avoiding any dispute in that regard. A well advised buyer may also consider it prudent to seek to agree in the sale and purchase agreement that any alleged failure to give notice as contemplated does not prevent the buyer from making a claim but may, for example, be taken into account in relation to matters concerning quantum (but not the validity of the notice itself).

Judges: Underhill LJ, Popplewell LJ and Nugee LJ.

Material Adverse Effect in the time of COVID

In *Travelport & Ors v WEX Inc; Olding & Ors v WEX Inc* [2020] EWHC 2670 (Comm) the Commercial Court considered the interpretation of a Material Adverse Effect clause, in the context of the COVID-19 pandemic. It is the first COVID-related 'Material Adverse Effect' dispute to come before the English courts and has determined a number of preliminary issues for the purposes of assessing whether the pandemic had a disproportionate effect on the targets of an M&A transaction as compared to other industry participants.

Facts

In a share purchase agreement ('**SPA**') between the defendant buyer, WEX Inc, a financial technology services provider ('**Buyer**'), and the claimant sellers of the target companies, which belonged to the Optal and eNett group of companies respectively ('**Sellers**') one of the conditions precedent to the Buyer's obligation to close the deal, entitled 'No Material Adverse Effect', read as follows:

'Since the date of this Agreement there shall not have been any Material Adverse Effect and no event, change, development, state of facts or effect shall have occurred that would reasonably be expected to have a Material Adverse Effect'.

The definition of Material Adverse Effect ('**MAE**') was detailed and included a list of nine matters that would not be construed to be a MAE ('**Carve-Outs**'). This included '*conditions resulting from any… pandemics*'. However, the definition of MAE also provided that such conditions could be taken into account to determine whether there had been a MAE, if the event in question has had *'a disproportionate effect on [the target companies], taken as a whole, as compared to other participants in the industries in which [they] operate'* ('**Carve-Out Exception**').

On 4 May 2020, the Buyer notified the Sellers that, as there had been a MAE due to *'conditions resulting from the SARS-CoV-2 pandemic'*, it was not obliged to close the transaction. On 11 May 2020, the Sellers issued claims for a declaration that no MAE has occurred or is reasonably expected to occur; and for specific performance by the Buyer of its obligations under the SPA. Given that the Buyer's funding would lapse on 27 October 2020 had the transaction not been completed by then, the Court expedited the trial of various preliminary issues.

Decision

On the question of burden of proof, the Commercial Court held that the Buyer had the burden of proving whether and to what extent any effect within the Carve-Outs fell within the scope of the Carve-Out Exception. Practically speaking, this meant that the Buyer had to show that the conditions resulting from the COVID-19 pandemic had a disproportionate effect on the target companies, as compared to other participants in the industries in which they operate.

The question of which industry or industries were relevant to the Carve-Out Exception, i.e. when considering the relative effect of the pandemic on the target companies compared with other companies, proved to be more complicated. The Sellers' case was that such comparison is to be carried out by reference to the travel payments industry. The Buyer claimed it should be done by reference to the broader business to business payments industry, or even just the payments industry in general.

In considering this question, the Commercial Court took several factors into account, including the construction of the MAE clause and the commercial purpose of the MAE clause and the transaction.

On construction, the Commercial Court decided that no special principles of interpretation applied to MAE clauses in English law. There was also no authority to suggest that MAE clauses are required to be construed contra proferentem, i.e. against the party seeking to rely on such clause. The starting point of the Commercial Court was to note that the parties had chosen the word '*industries*' and not 'markets', 'sectors' or 'competitors', all of which are narrower than '*industries*'. The SPA also made use of the term '*businesses*' in other places, indicating that the parties had sought to distinguish between the two terms.

The commercial purpose of the transaction was held to be admissible as factual matrix evidence, i.e. relevant background of a sufficiently material nature bearing on the parties' objective understanding of the terms to which they had agreed. While the Commercial Court accepted that evidence of the parties' intentions was not admissible as factual matrix evidence, it was permissible to consider the parties' intentions *'solely with a view to evaluating the objective purpose of the deal'* (emphasis added).

Bearing the above in mind, the Commercial Court found that the Sellers' case, that the transaction was considered to be just a purchase of a travel payments business, was an oversimplification. Although the Buyer was particularly interested in the travel-specific perspective of the target companies, there was evidence to show that the Buyer was cognisant of the possibility of expanding their offering to other verticals (i.e. business areas). In other words, the transaction *'carried with it future value in other markets'*.

The Commercial Court also concluded that there was no such industry as the travel payments industry, whether as defined by the Sellers or more broadly. The Sellers' definition of the term was one that materialised in the litigation and, in any event, there was a paucity of the use of the term even generally which indicated that it is not in everyday use. However, the payments industry and business to business payments industry clearly existed.

Owing to a dearth of English case law on MAE clauses, the Commercial Court drew heavily on the Delaware case of *Akorn Inc. v Fresenius Kabi AG,* No. 2018-0300-JTL, 2018 WL 4719347 (Del. Ch. October 1, 2018), given the similar structure of the MAE clause that was in dispute. In that case, the Court found that, *'consistent with standard practice in the M&A industry'*, the risk of *'endogenous, business-specific events'*, i.e. those events with an internal cause or origin, was allocated to the seller and that of '*exogenous, systematic risks*', i.e. those events with an external cause or origin, was allocated to the buyer.

It was the Sellers' case that the MAE clause operated as a backstop to the allocation of business risk, with the warranties, representations and covenants in the SPA serving as the primary safeguards against such risk. The Buyer argued that the MAE clause ought to be seen as a separate protection directed to a different risk, namely a commercial allocation of how much systemic (as opposed to specific) risk each party was to bear in the period prior to the closing of the transaction. The Commercial Court could find no clear authority or rationale in favour of the Sellers' arguments and concluded that the Buyer's construction was the preferred one. It followed that the comparison exercise for the purposes of the Carve-Out Exception was to be carried out with reference to the participants in the business to business payments industry or the payments industry.

Comment

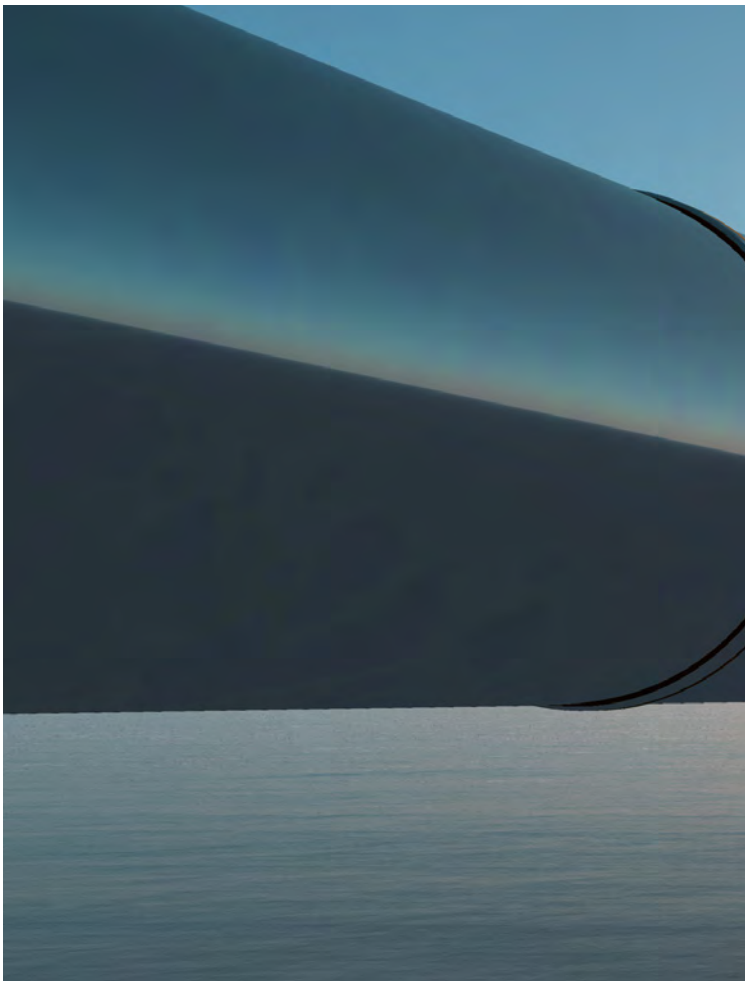
The Commercial Court has provided a valuable insight into the interpretation of MAE clauses. Although the Commercial Court accepted that the burden is on the buyer to prove that a particular carve-out to an MAE clause falls within an exception to that carve-out, the judgment gives an indication of factors that the Court is likely to take into consideration in arriving at its own interpretation of the clause.

Specifically, the decision of the Commercial Court highlights the critical importance of the words used when drafting MAE clauses. The Commercial Court carried out a careful analysis of the MAE clause, in the context of the words used elsewhere in the contract. In doing so the analysis noted that the parties had referred to '*industries*' and not 'markets', 'sectors' or 'competitors', all of which are narrower than '*industries*'. The SPA also made use of the term '*businesses*' in other places, indicating that the parties had sought to distinguish between the two terms. Such analysis emphasizes the importance of ensuring that MAE clauses are drafted and understood in the context of the contract as a whole.

In citing the *Akorn* case, the Commercial Court acknowledged that parties often prefer to leave certain terms undefined because the resulting uncertainty generates productive opportunities for renegotiation. However, this brings with it the risk that a failure to renegotiate will result in the Court having to *'fashion an objective intent which was never subjectively shared by the parties'*.

In the meantime, permission to appeal the judgment has been granted and so the Court of Appeal may have the opportunity to remedy the dearth of English case law on MAE clauses and provide insight into an area of law that will likely have far reaching implications on parties with similar contractual provisions.

Judge: Cockerill J.



Supplementary Charge: 'just and reasonable' apportionment of profit

In *Total E&P North Sea UK Limited (formerly Maersk Oil North Sea UK Limited) and Total Oil UK limited (formerly Maersk Oil UK Limited) v HMRC* [2020] EWCA Civ 1419, the Court of Appeal considered the requirement for a '*just and reasonable*' apportionment of profit between accounting periods for the purposes of the supplementary charge applicable to profits arising from UK oil and gas activities.

Facts

Total E&P North Sea (formerly Maersk Oil North Sea UK Limited) and Total Oil UK Ltd (formerly Maersk Oil UK Limited) (the '**Companies**') each carried on oil exploration and production activities in the UK, and were accordingly subject to ring fence corporation tax and the supplementary charge on their adjusted ring-fence profits.

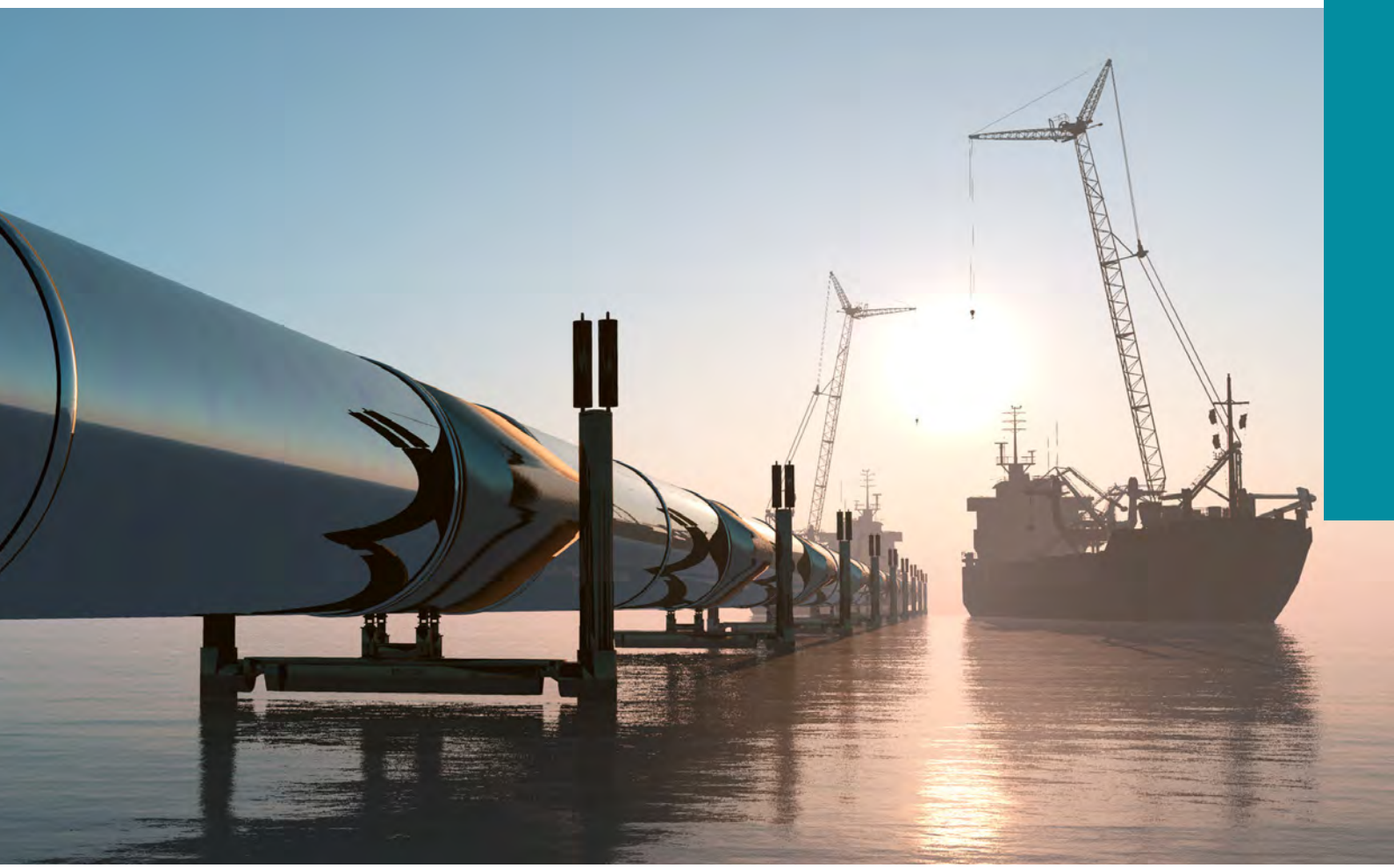
On 23 March 2011, the rate of the supplementary charge increased from 20% to 32%. Following Royal Assent of the Finance Act 2011, the increased rate applied in relation to any accounting periods beginning on or after 24 March 2011. Where accounting periods straddled that date, the periods before and after 24 March were to be treated as two separate accounting periods for the purposes of calculating the supplementary charge.

Under the legislation, profits were required to be apportioned between these two periods in proportion to the number of days in those periods (i.e. a time apportionment method). The legislation also provided (under section 7(5) of the Finance Act 2011) that if this basis of apportionment worked '*unjustly or unreasonably*', then a company could elect for its profits to be apportioned under another basis that was '*just and reasonable*', as specified in their election.

The Companies both had an accounting period that ran from 1 January to 31 December 2011 and therefore straddled the point at which the supplementary charge was increased. The Companies each made an election under section 7(5), and used an alternative basis of apportionment which broadly involved calculating the profits for the periods before and after 24 March on an actual basis, by reference to the income, expenditure and allowances relating to the period in which they arose.

The result of such allocation was that the adjusted ring fence profits for the calendar year accounting period were allocated to the period before 24 March, rather than that from 24 March, and were therefore subject to the lower 20% supplementary charge. The timing of profits within the period was partly due to a significant incident and shut-ins affecting various of the Companies' fields during the later period.

HMRC challenged the Companies' method of apportionment, disputing that the basis on which the companies approached their adjusted ring fence profits



was '*just and reasonable*'. The First Tier Tribunal accepted that the Companies' method was just and reasonable; however, the Upper Tier Tribunal had taken a different view on appeal, stating that the method went beyond what was required to compensate for the incident and shut-ins, and that in these circumstances an alternative approach to the default method of time apportionment could not be justified.

Decision

The Court of Appeal allowed the appeal of the Companies, and overturned the decision of the Upper Tribunal. While time apportionment was intended to be the default method, this did not mean that an alternative approach could only be used in exceptional circumstances or circumstances unique to the company in question. Any company that had profits that were not smooth across the straddling period, and that could therefore be materially prejudiced by a time apportionment method, should be entitled to use the alternative afforded by section 7(5) of the Finance Act 2011. The Companies had accordingly applied a just and reasonable method of apportionment between the periods in question.

Comment

This case provides useful insight into the Court's assessment of what constitutes a '*just and reasonable*' apportionment, which is used not only in relation to the supplementary charge but elsewhere in tax legislation. In particular, it demonstrates that an apportionment based on the actual position for those periods is capable of being just and reasonable, including in circumstances where this produces a very different result from a default time apportionment method.

Judge: King LJ, Newey LJ, Andrews LJ.

Chapter 3

Engineering, Procurement and Construction Contracts

The Technology and Construction Court has delivered a series of decisions that are important for drafters of engineering, procurement and construction contracts:

— In *Engie Fabricom (UK) Ltd v MW High Tech Projects UK Ltd* [2020] EWHC 1626 (TCC) the Technology and Construction Court revisited the exclusion of power generation from compulsory adjudication.

— In *Energy Works (Hull) Ltd v MW High Tech Projects UK Ltd* [2020] EWHC 2537 (TCC) the Technology and Construction Court considered the impact of a provision requiring assignment of subcontracts on termination.

— In *Mott MacDonald Ltd v Trant Engineering Ltd* [2021] EWHC 754 (TCC) the Technology and Construction Court considered whether an act of wilful misconduct meant that a limitation clause should not apply.

— In *Triple Point Technology, Inc (Respondent) v PTT Public Company Ltd* (Appellant) [2021] UKSC 29 the Supreme Court overturned a Court of Appeal ruling on the application of liquidated damages for delay in termination scenarios and restored the 'orthodox' position that the contractor should be liable for liquidated damages up to termination and thereafter general damages should apply.

— In *Dr Jones Yeovil Ltd v The Stepping Stone Group Ltd* [2020] EWHC 2308 (TCC) the Technology and Construction Court warned of the potential damages in excluding third party rights.

Exceptions to Construction Act adjudication requirements

Section 105 of the Housing Grants, Construction and Regeneration Act 1998 (the '**Construction Act**') exempts from the scope of compulsory statutory adjudication of disputes, amongst other things, drilling for, or extraction of, oil or natural gas, and assembly, installation or demolition of plant or machinery, or erection or demolition of steelwork for the purposes of supporting or providing access to plant or machinery, on a site where the primary activity is power generation. In *Engie Fabricom (UK) Ltd v MW High Tech Projects UK Ltd* [2020] EWHC 1626 (TCC), the Technology and Construction Court determined the scope of the power generation exception.

Facts

The Construction Act applies to contracts for 'construction operations' carried out within the United Kingdom, save for certain classes of contract excluded by regulation and a narrow set of exemptions provided by section 105, which include the *'assembly, installation or demolition of plant or machinery … on a site where the primary activity is … power generation'*, as well as other engineering projects such as nuclear processing and sewage treatment plants.

MW High Tech Projects UK Ltd ('**MW High Tech**') was contracted to design, manufacture, supply and install a fluidised bed gasification plant capable of processing fuel derived from residual domestic and commercial waste (i.e. after the removal of recyclables and organic material). MW High Tech subcontracted the installation of the gasification plant to Fabricom. Payment disputes arose which Engie Fabricom (UK) Ltd ('**Fabricom**') referred to adjudication and subsequently received decisions in its favour.

The statutory right to adjudicate conferred by the Construction Act applies only to construction contracts. The subcontract contained a contractual right to adjudicate also, but *'only to the extent (if any) required by the [Act]'*. If the subcontract works were not 'construction operations' under the Construction Act, therefore, no right to adjudicate, statutory or contractual, would exist.

MW High Tech argued that the primary activity on the site was power generation (and not waste treatment as Fabricom contended) and that the subcontract was not for 'construction operations'.

Decision

The Technology and Construction Court conducted a detailed factual analysis to reach its conclusion as to the primary activity on the site, considering a variety of factors, including regulatory and planning issues, operations on site, the contract terms and investment sources for the plant.

Ultimately, the Technology and Construction Court decided that the primary activity was power generation for the following reasons:

1. MW High Tech's main contract was strong evidence that the primary purpose was energy generation, as it specified that pre-treated waste was to be brought to the plant as fuel for energy production with very limited further treatment required on site, and the performance of the plant was to be measured by reference to energy production and not waste throughput;

2. the Industrial Emissions Directive permit issued by the Environment Agency was issued for a waste incineration plant, but the scheme permits an operator to apply to change the status of the plant from disposal to recovery, and qualification for such an application was a requirement of the main contract;

3. there was no evidence that the plant was being developed in furtherance of any specific regulatory policy (neither waste management nor power generation);

4. the planning application for the plant referred both to a waste management facility and a renewable energy plant, and was therefore not determinative; and

5. the funding model estimated that most of the revenue would be generated by electricity sales.

Accordingly, there was no statutory or contractual right to adjudicate and Fabricom's claim for enforcement of the adjudication decisions was dismissed.

Comment

The exemptions in section 105 have in the past been narrowly construed. In *ABB Power Construction Ltd v Norwest Holst Engineering Ltd* [2000] EWHC 68 (TCC): *'drilling for oil and gas is excluded but drilling for water (even if it is ultimately to be treated) is not; a project for tunnelling to lay a sewer (even if it is going to a sewage works) or to construct a railway has to be regulated but not a project requiring a tunnel for minerals; installing plant for nuclear processing, and power generation, or for water and effluent treatment is excluded but not plant for an incinerator'*.

The exemptions are also narrow in that they do not exempt entire projects, but only those activities concerning plant, machinery or supporting steelwork. This results in construction contracts which are only partly subject to the Construction Act – known as 'hybrid contracts'.

This case once more highlights the difficulties attending the exemption provisions of the Construction Act, which continue to attract criticism from the judiciary. The Technology and Construction Court in this case lent its support to these criticisms noting that there was a '*powerful argument*' for legislative reform. During Parliamentary debates over the Construction Act, it was suggested (by Lord Howie of Troon) that the then Government had been *'got at by some big, powerful, important interests in what are called the process industries. They yielded to those pressures and in so doing lost sight of the aim of the Bill'*. A recent consultation on amending the Construction Act unsurprisingly received suggestions that section 105 be reviewed. It remains to be seen whether the consultation will be taken forward into legislative reform by the present Government and, if so, whether the interest groups which led to the current version of section 105 will lobby against reform.

The Technology and Construction Court's findings will, nevertheless, provide substantial guidance for those negotiating contracts for the construction of energy from waste plants. Whilst each case will turn on its own facts, those plants which receive waste material as fuel and do not carry out significant waste treatment operations are likely to fall within the power generation exemption, especially where the financial and performance criteria for the plant are directed toward energy production rather than waste throughput.

Judge: O'Farrell J.

Assignment of sub-contracts on termination: contractors beware

In *Energy Works (Hull) Ltd v MW High Tech Projects UK Ltd* [2020] EWHC 2537 (TCC) the Technology and Construction Court considered the effect of provisions which require contractors to assign sub-contracts on termination for default by an employer. The Technology and Construction Court's decision meant that the contractor in this case had no recourse to sub-contractors in respect of claims from the employer following termination and was limited in the respects in which it could seek contribution under the Contribution Act. Similar assignment provisions appear in many engineering, procurement and construction contracts, making the Technology and Construction Court's findings of broad application.

Facts

In 2015, Energy Works (Hull) Ltd ('**EWHL**') appointed MW High Tech Projects UK Ltd ('**MW**') as its main contractor for the design, procurement, construction, commissioning and testing of a waste to energy plant in the north of England. In turn, MW sub-contracted certain elements of the project to Outotec (USA) Inc ('**Outotec**').

The project ran into difficulty, suffering significant delays, and EWHL purported to terminate MW's contract for a 'contractor default' being that the delays to completion of the works (including works to remedy defects) were such that the delay damages exceeded the contractual cap on delay damages for which MW could be liable.

MW argued that it was entitled to additional time for completion and that EWHL was not entitled to terminate for breach, and that the termination took effect as one for convenience. However, a consequence of the termination was that MW was required to assign its sub-contract with Outotec, which it duly did by way of notice.

MW sought to pass on to Outotec any liability it might be found to have to EWHL. Outotec objected on the basis that its contract with MW had been assigned to EWHL. In response, MW argued that (i) the assignment of the sub-contract was an assignment of future rights only (and not past or accrued rights) or (ii) alternatively that if past and accrued rights were assigned, MW could claim a contribution from Outotec under the Civil Liability (Contribution) Act 1978 (the '**Contribution Act**').

Decision

Assignment

In considering whether both accrued and future rights had been assigned, the Technology and Construction Court emphasised the use of the expression *'assign the subcontract'* and followed previous caselaw which had taken that term to mean the assignment of accrued and future rights. The Technology and Construction Court noted that whilst it would be possible to limit an assignment to future rights only, clear words would be required in order to do so.

As to MW's argument that it would be an *'implausible and uncommercial interpretation'* to find that the contractual intention was for MW to lose its right to sue Outotec, the Technology and Construction Court disagreed and remarked that this was simply the assumption of a commercial risk by MW, and an extension to the risk that it might lose or limit its right to sue Outotec for other reasons, such as Outotec's insolvency or as a result of a contractual limit of liability.

Contribution

Having divested itself of any direct rights to claim against Outotec, MW sought contribution from Outotec in respect of its liability to EWHL. Claims for contribution may be made under the Contribution Act where two parties are liable for the '*same damage*' suffered by a third party. The third party is able to claim in full against either of the wrongdoers, who will then be entitled to '*contribution*' from the other on a just and equitable basis having regard to the extent of each party's responsibility for the damage. Contribution claims are often brought in construction disputes between designers and contractors in relation to allegations of defective work caused both by design and workmanship issues.

Outotec resisted MW's claim for contribution on the basis that any damage caused by breaches of its sub-contract were suffered at the sub-contract level and were distinct from the damage suffered by EWHL under the main contract. MW claimed that defects in Outotec's work under the sub-contract were the cause of delay under the main contract for which EWHL had terminated and were accordingly for the '*same damage*' as that suffered under the main contract.

The Technology and Construction Court came to different conclusions on this issue for different heads of claim:

— In relation to delay damages claimed by EWHL, the Court found the answer depended on the extent to which the periods of delay overlapped under the main contract and sub-contract. Overlapping periods of delay would be for the '*same damage*' whereas distinct periods would not – they would concern *'the same type of harm but not the same harm'*.

— The termination losses claimed by EWHL (i.e. additional costs of completion) were held not to be the '*same damage*' as any liability Outotec may have under the sub-contract. Outotec had no obligation to satisfy MW's time obligations under the main contract and there was therefore no route by which EWHL as assignee of the sub-contract could claim the additional costs of completion from Outotec.

— EWHL's claim for defects against MW was held to represent the '*same damage*' as the parallel claim it had as assignee under the sub-contract. Although the claims arose at different contractual tiers, they related to the same damage or harm i.e. a defective plant.

Comment

This is a significant decision which is likely to be of wide application. Provisions requiring the assignment of sub-contracts on termination for default are common in engineering, procurement and construction contracts.

The position under the FIDIC forms is similar, although rather than conferring an absolute right to instruct assignments, the Contractor need only comply with

'reasonable instructions … given by the Employer … for the assignment of any subcontract' (see, for example, Clause 15.2.3 of the Yellow Book, 2017 Edition).

Despite the ubiquity of such provisions, their scope and operation have rarely been tested. A particular point of ambiguity concerns how the contractor's legal relationship with its sub-contractors is affected by such assignments. Having terminated for default, the employer will typically make large claims against the contractor for the cost of completing the works, delay and other termination losses. A contractor would usually seek to pass such claims onto its supply chain where possible, but what of the assignments made to the employer? May the contractor still pass on liabilities under sub-contracts which have been assigned to the employer?

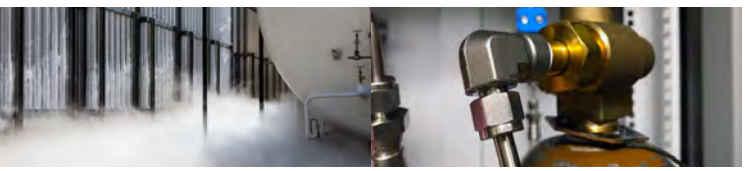
If the contractor is unable to pass on such liabilities, its exposure to employer claims may be much greater than expected. The decision of the Technology and Construction Court will have direct application to many contracts. However, the decision may be less easily applied to the FIDIC form, given the presence of a reasonableness requirement: it might be argued, for example, that the distinction advanced by MW in the present case between the assignment of future rights of performance and accrued rights represents a reasonable balance between the interests of the employer in securing future performance of sub-contractors post-termination and the interests of the main contractor in preserving rights against its supply chain in respect of the employer's termination.

The Technology and Construction Court's findings as to contribution are complex and pose a number of issues for consideration in future cases. For example, the importance given to overlapping periods of delay under the main contract and sub-contract is not articulated in any detail by the Court. There is also little analysis of the employer's position and whether its claims under the main contract and sub-contract could be cumulative in certain circumstances. For example, at least part of the delay claims under both contracts in this case were liquidated. MW's assignment to EWHL of this claim under the sub-contract appears to be a simple assignment of a debt, which might be thought to be recoverable by EWHL in addition to the liquidated damages payable by MW under the main contract. Such a conclusion, however, is difficult to reconcile with the Court's analysis of MW's rights under the Contribution Act.

What is clear from the decision is that assignment provisions such as those considered in this case represent a significant exposure to main contractors in the event of a termination for default. Such parties may wish to consider amendments allowing for the assignment of future rights only, or to adopt the FIDIC position of allowing the employer to instruct only such as assignments as are reasonable.

The decision may also lead to an increase in non-assignment clauses being included in sub-contracts. Such provisions effectively seek to put the assignment of the sub-contract out of the contractor's reach and may avoid the position which the contractor faced in the present case. Whether contractors will be at liberty to propose such restrictions themselves will depend on the terms of the applicable main contract, as some will require the contractor to ensure the assignability of sub-contracts where possible.

Judge: O'Farrell J.



Limitation of liability in construction contracts: the relevance of intentional or repudiatory breaches

In *Mott MacDonald Ltd v Trant Engineering Ltd* [2021] EWHC 754 (TCC) the Technology and Construction Court considered the interpretation of general exclusions and limitations of liability. It sought to resolve conflicting case law as to whether any interpretative presumption exists against the exclusion or limitation of liability for deliberate breaches of contract.

Facts

Trant Engineering Ltd ('**Trant**'), an engineering contractor, engaged Mott MacDonald ('**MM**') for design consultancy services in connection with the construction of a new power station at a military base in the Falkland Islands. Following an initial dispute, the parties entered a Settlement and Services Agreement ('**SSA**') to resolve the existing dispute and govern the parties' obligations on the project going forward. The SSA contained a total cap on liability of GBP 500,000, exclusions on liability and a net contribution clause.

Following Trant's failure to make certain payments, MM commenced proceedings. Trant counterclaimed for GBP 5m alleging that MM had *'fundamentally, deliberately and wilfully'* breached the SSA by a refusal to perform. MM denied the breach, but contended that even if Trant could prove breach, and those breaches were deliberate and fundamental, the exclusion and limitation clauses in the SSA would still apply.

Decision

The Technology and Construction Court granted summary judgment for MM on this issue. It endorsed the position set out in *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827 and as summarised in the *AstraZeneca UK Ltd v Albemarle International Corporation & another* [2011] EWHC 1574 (Comm) case.

In *Photoproductions* the House of Lords rejected the so-called doctrine of fundamental breach which disabled a party from relying on an exclusion clause where a contract had been brought to an end as a result of a fundamental breach of contract, such as by repudiation. Instead, whether an exclusion clause was to be applied to any given breach of contract was a matter purely of contractual interpretation.

The Technology and Construction Court decided that exclusion clauses, including those purporting to exclude or limit liability for deliberate and repudiatory breaches, are to be construed by reference to normal principles of contractual construction without the imposition of a presumption and without requiring any particular wording to achieve the effect of excluding liability. This finding was subject to the provision that an exclusion or limitation of liability will not be read as operating to reduce a party's obligations to the level of a mere declaration of intent.

Following this approach, the Technology and Construction Court found that the clauses in the SSA were in clear terms and capable of applying to the alleged breaches, noting that the SSA was a bespoke agreement intended to be a comprehensive regulation of the parties' future dealings.

On the facts, the Technology and Construction Court was satisfied that the presence of the GBP 500,000 liability cap made it impossible to argue that the limitation clause rendered the contract a mere statement of intent as it provided for a substantial (if limited) remedy. On the basis that in the event of a repudiatory breach accepted by Trant as terminating the SSA, MM would remain liable up the level of the cap.

Comment

The construction and interpretation of exclusion and limitation clauses continues to raise questions as to the proper approach. However, it is arguably clear that there is no presumption against the application of such clauses to deliberate breaches.

English law differs from other jurisdictions where exclusions for gross negligence and/or wilful misconduct are not permitted. If it is the parties' intention to ensure gross negligence or wilful misconduct is not exempted by an exclusion or limitation of liability clause, they must say so. Many oil and gas model form agreements cater expressly for such circumstance by providing for carve outs from exclusion clauses.

However, the view widely expressed that, subject to the *nudum pactum* principle, such clauses should be interpreted and construed in the same way as other clauses is questionable. Whilst it is correct that the Court must apply clear words, the better view is arguably that clear wording would be needed to exclude any obligation arising in law (implied term or obligation to pay the usual measure of damages).

Judge: HHJ Eyre QC.

Post-termination liquidated damages: orthodoxy restored

In *Triple Point Technology, Inc v PTT Public Company Ltd* [2021] UKSC 29 the Supreme Court overturned a Court of Appeal ruling on the application of liquidated damages for delay in termination scenarios. While ultimately the question will be one of interpretation of the clause in question, the Supreme Court has restored the 'orthodox' position that the contractor should be liable for liquidated damages up to termination and thereafter general damages should apply.

Facts

PTT Public Company Ltd ('**PTT**') entered into a contract for the procurement of software and related services from Triple Point Technology, Inc ('**Triple Point**'). The contract documents provided for payment by milestones, but also included specific dates for payment. Work under the contract was delayed and Triple Point sought payment according to the dates referred to in the contract documents. PTT refused payment on the basis that the relevant milestones had not been achieved. Triple Point suspended work for non-payment and PTT purported to terminate the contract for Triple Point's default.

Among other issues in dispute, a question arose as to whether PTT could claim liquidated damages for delay. The clause in question required Triple Point to pay, *'the penalty at the rate of 0.1% (zero point one percent) of undelivered work per day of delay from the due date for delivery up to the date PTT accepts such work'*. The Technology and Construction Court decided that PTT was entitled to liquidated damages up until the date of termination in respect of incomplete milestones. The Court of Appeal disagreed, finding PTT was only entitled to delay liquidated damages for works that had actually been completed (albeit late) prior to termination.

Decision

Liquidated Damages

The liquidated damages clause at Article 5.3 of the contract provided:

'If CONTRACTOR fails to deliver work within the time specified … CONTRACTOR shall be liable to pay the penalty at the rate of 0.1% (zero point one percent) of undelivered work per day of delay from the due date for delivery up to the date PTT accepts such work'.

In overturning the Court of Appeal's judgment, the Supreme Court decided that the Court of Appeal erred in finding that the wording of Article 5.3 was sufficiently similar to that in *British Glanzstoff Manufacturing Co Ltd v General Accident, Fire and Life Assurance Corpn Ltd* [1913] AC 143, a previous House of Lords decision from 1912. The liquidated damages clause in *British Glanzstoff*, was not market-accepted wording or a standard form clause and therefore could not be authority for any legal principle, even if the contractual wording was similar. The case was one which turned on its particular facts and did not establish any general proposition of law.

The Supreme Court went on to state that clear words would be required to overturn what is understood to be the 'orthodox approach', being that liquidated damages would be payable for delays up to termination, and thereafter the contractor would be liable in general damages for the employer's termination losses. Indeed, Triple Point was unable to provide the Supreme Court with any examples of where standard form contracts expressly provided that liquidated damages for delay would only be payable if the contractor actually completes the work; the only example cited was Clause 15.4(c) of the 2017 FIDIC Yellow Book which reflects the 'orthodox' approach.

The Supreme Court dismissed the Court of Appeal's concern that the orthodox approach might result in the employer finding itself in '*new territory*' with an '*artificial*' categorisation of the employer's losses as being a specific amount per day or week up to a certain date and then general damages thereafter. Instead, it considered that it is established law that the accrual of liquidated damages comes to an end on termination of the contract, after which the parties must seek general damages for breach of contract.

The Court of Appeal's approach was also criticised for being inconsistent with commercial reality and the accepted function of liquidated damages, i.e., that they benefit each of the employer (in avoiding the need to prove actual loss flowing from the delay) and the contractor (in providing certainty as to its liability in the event of its culpable delay). As such, and applying established rules of interpretation to Article 5.3, the Supreme Court considered that it could be fairly and reasonably interpreted as meaning *'up to the date (if any) PTT accepts such work'*.

Exclusion for 'negligence'

By a slim majority, the Supreme Court also overturned the Court of Appeal's ruling on the application of the carve-out from the cap on liability for 'negligence'. The contract provision in question was as follows:

'This limitation of liability shall not apply to CONTRACTOR's liability resulting from fraud, negligence, gross negligence or wilful misconduct of CONTRACTOR or any of its officers, employees or agents'.

The Court of Appeal had found that the reference to '*negligence*' here referred to '*free standing tort of negligence*' that did not include breach of contractual duty of care or a concurrent duty of care in tort. As such, damages that arose due to the contractor's negligent breach of contract fell within the cap on liability.

The Supreme Court disagreed. It decided that the provisions should be interpreted in the context of the preceding sentences of exclusion clause, which expressly referred to '*breaches of contract*' and liability '*under*' the contract, and the scope of services and deliverables Triple Point had agreed to provide under the contract. Applying established rules for interpreting contracts, '*negligence*' in this clause should be given its accepted meaning in English law, i.e. incorporating both a breach of contractual duty of care and the tort of failure to use due care.

Comment

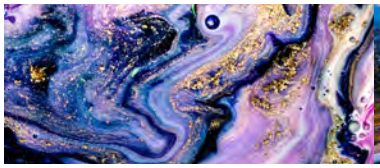
The Supreme Court's ruling will be welcomed by contracting parties to engineering, procurement and construction contracts who benefit from the commercial certainty that delay liquidated damages provide.

The Court of Appeal's decision had raised difficult issues for parties considering termination of a contract with the potential for accrued rights to delay liquidated damages being replaced with a general right to damages only and the attendant difficulties of proof that a general damages claim can give rise. The Supreme Court's decision sweeps away this difficulty and considerably simplifies this area of the law. Absent clear wording to the contrary, liquidated damages for delay accruing prior to termination will remain intact, with a general claim for damages applying only in relation to post-termination losses.

Parties may still wish to deal expressly in their contracts with how liquidated damages for delay will be applied in termination scenarios – particularly if something other than the 'orthodox' position upheld in this case is intended.

The Supreme Court's decision also gives further encouragement, if any were needed, to pay close attention to how caps on liability (and any exclusions from them) are drafted. In relation to the interpretation of exclusion and limitation clauses, the Supreme Court decision does not finally resolve whether the principle in *Modern Engineering (Bristol) Ltd v Gilbert-Ash (Northern) Ltd* [1974] AC 689 remains good law. However, it strongly suggests that it does. As such, clear wording is likely needed to exclude an obligation implied by law or category/scope of damages.

Judges: Lord Hodge JSC, Lady Arden JSC, Lord Sales JSC, Lord Leggatt JSC, Lord Burrows JSC.



Black Holes and Revelations

In *Dr Jones Yeovil Ltd v The Stepping Stone Group Ltd* [2020] EWHC 2308 (TCC), the Technology and Construction Court has raised the spectre of oil and gas companies not being able to recover full damages from contractors or suppliers for defective performance under construction, procurement or supply chain contracts due to a 'black hole'. The risk arises from 'boiler plate' third party wording. Although many contractual arrangements in the oil and gas industry will already negate this risk, it is critical that parties are alive to the issue identified by the court.

Legal 'black hole'

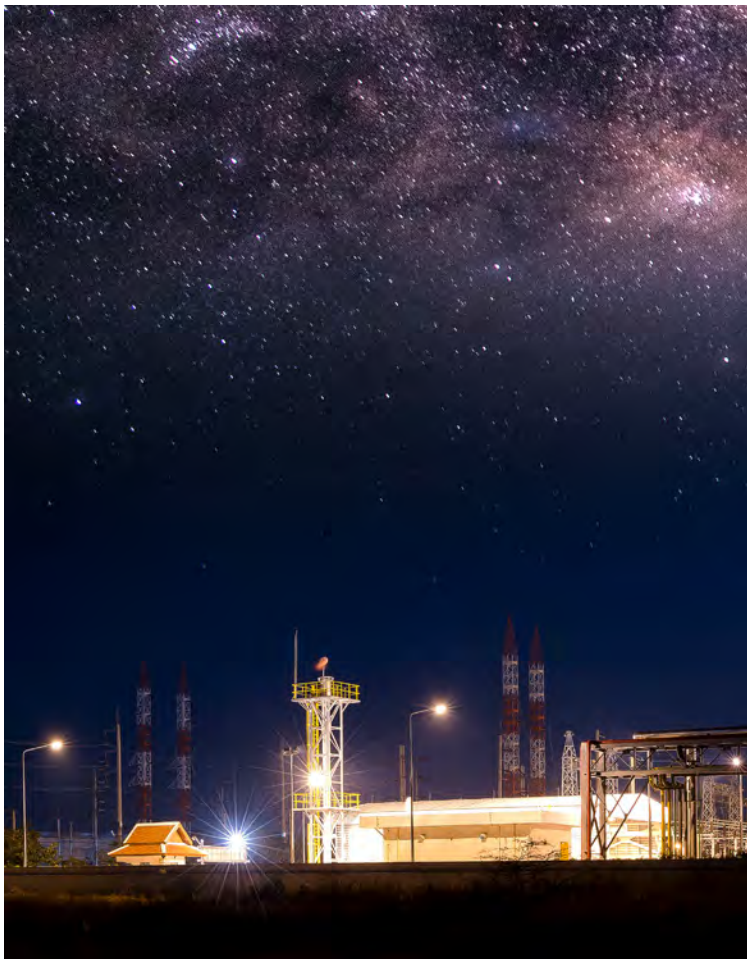
A legal 'black hole' is said to arise when one party to a contract is unable to claim full damages in relation to a breach of the contract because the loss is incurred by a third party. An example might be a defect in the work under a field development (EPC) or ship construction contract where the company or employer engaging the contractor is not the owner of the facilities or vessel arising from that work. There is also potential for issues to arise in procurement contracts entered into by an operator under joint operating agreements.

The principle of 'transferred loss' has traditionally allowed one party to claim losses of more than it itself is entitled to in the event of breach. It was developed to overcome black holes.

In *Dr Jones Yeovil Ltd v The Stepping Stone Group Ltd,* the issue arose as to whether the principle of transferred loss would apply where parties have included wording in their contract disclaiming any intention to confer rights on third parties. Such wording is commonly included as boilerplate language in standard form oil and gas, and shipping contracts.

Facts

An employer engaged a contractor to build and refurbish assisted living units for elderly residents. The employer's subsidiary owned the property. The property was placed by the subsidiary on three separate long leases to third parties.



The employer alleged defects in the work, as the contractor had installed off-spec, inefficient heat pumps. The employer claimed for the resultant increase in electricity usage costs.

The contractor claimed that the employer had not itself suffered any increased electricity costs, as it was neither the owner nor the occupier of the property; the electricity costs were suffered by the leaseholders.

The employer sought to rely on the principle of 'transferred loss' – arguing that the development was ultimately for the benefit of the leaseholders, which was known and agreed to by the contractor. In other words, its interest as employer under the contract enabled it to recoup the losses suffered by the leaseholders.

The contract was based on a standard JCT contract. The standard third party rights clause read:

'…nothing in this contract confers or is intended to confer any right to enforce any of its terms on any person who is not a party to it'. There were carve outs for third party rights specified in the contract in favour of purchasers, tenants or funders – not 'leaseholders'.

In evidence, the Employer stated that there was a deliberate decision not to confer on the leaseholders third party rights or the benefit of collateral warranties so as to avoid them being left to bring their own claims against the Contractor. The Employer's view was that it was following 'housing association practice' in this regard.

Decision

The Technology and Construction Court reviewed the authorities on the principle of transferred loss.

The reasoning underpinning the principle of transferred loss was the need to avoid an unacceptable 'legal black hole' where a contract-breaker escapes financial accountability because its contractual counterparty cannot be shown to have suffered the relevant loss.

As the key to avoiding such a consequence lies in establishing that the parties to the contract knew that one or more third parties were to benefit from its proper performance (and would likely suffer the resulting loss if there was a breach) it is also clear that the principle touches upon some elementary principles relating to privity of contract and the recognition of separate legal personalities.

These considerations include the potential significance of the Contracts (Rights of Third Parties) Act 1999. The Technology and Construction Court will not recognise the existence of a black hole (as between the contract-breaker and its counterparty) if the third party who benefits from contractual performance has its own, separate right of redress or where a company contracts for the benefit of an associated company but does not tell the other party (the contract-breaker) that it is doing so.

As the principle of transferred loss is an exception to a fundamental principle of the law of obligations, it is driven by legal necessity. The fundamental implications of recognising the distinct legal personality of a company indicates that those who decide to contract through a chosen corporate entity may face difficulties

in making out such necessity if the black hole can be said to be of their own making.

On the facts the black hole was upheld. There was no room for the operation of the principle of transferred loss in the face of the third party rights clause under the contract.

The carve outs to the general exclusion of third party rights in the contract were in favour of specified, named or identified third parties (in this case purchasers, tenants or funders). However, no such rights had been specified for leaseholders, pursuant to what the employer had said to be 'housing association practice' not to leave leaseholders to bring their own claims against the contractor.

The Technology and Construction Court said that the third party rights provisions:

'were express contractual provisions amounting to a positive disclaimer of the suggested third party benefit. To put it another way, they constituted a contractual agreement as to the factual position which is sufficient to support a contractual estoppel against the existence of knowledge of any such benefit…the principle of transferred loss is an exception to the law of obligations. When the parties to the contract have specifically addressed the lack of third party entitlement, and curtailed obligations accordingly, I can see no proper basis for overriding their agreement'.

Comment

To shoehorn in lyrics from Muse's delightful single, 'Starlight', the employer in this case may have had 'hopes and expectations' of its ability to claim the losses but it was met with 'black holes and revelations'. And what revelations they are: boilerplate third party rights provisions can oust any opportunity for the principle of transferred loss to be applied, even if the intention – at least of one party – was for third parties to benefit. As ever: it depends what the contract says.

Since the enactment of the Contracts (Rights of Third Parties) Act 1999, clauses disclaiming any intention to benefit third parties have become commonplace. The Technology and Construction Court's finding that such boilerplate provisions will prevent the principle of transferred loss from applying is therefore significant.

However, as many practitioners will know, many standard forms in the oil and gas and shipping industries will expressly provide for certain third party rights to be enforceable so as to avoid the black hole identified by the Technology and Construction Court.

For example:

LOGIC Decommissioning:

Clause 37.1: *'Subject to Clause 37.3, the PARTIES intend that no provision of the CONTRACT shall, by virtue of the Contracts (Rights of Third Parties) Act 1999…confer any benefit on, nor be enforceable by any person who is not a PARTY to the CONTRACT'.*

Clause 37.3: *'[the provisions of the indemnity regime] are intended to be enforceable by a Third Party'. 'Third Party'* includes, among others, the affiliates and contractors of the parties.

However, such third party rights are generally limited to the indemnities – it would not cover losses arising from a breach of a contract to which the third party is – by definition – not party.

In respect of oil and gas assets, commonly held in joint ownership, the joint venture arrangements side-step the third party rights / transferred loss issue entirely by introducing agency principles into procurement arrangements with contractors – in other words the parties suffering loss (the field / concession owners) are in fact party to the contract.

For example:

Clause 6.5.8 of OGUK JOA:

'[Operator] shall use reasonable endeavours to include in all contracts made pursuant to this Agreement, a provision which ensures that the Operator makes the contract on behalf of all the Participants…' and the provision to be included in such contracts reads in material part: '…the COMPANY and only the COMPANY is entitled to enforce the CONTRACT on behalf of all CO-VENTURERS as well as for itself. For that purpose the COMPANY shall commence proceedings in its own name to enforce all obligations and liabilities of the CONTRACTOR and to make any claim which any CO-VENTURER may have against the CONTRACTOR'.

Article 4.3.18 of the AIPN JOA:

'Operator shall…[i]nclude in its contracts with independent contractors and to the extent practical and lawful, provisions that …permit Operator, on behalf of the Parties, to enforce contractual warranties and indemnities against such contractors and their sub-contractors, and to recover from such contractors and sub-contractors losses and damages suffered by the Parties that are recoverable under their contracts'.

In the shipping industry, BIMCO mainly approaches the issue through 'Himalaya clauses' with a broad agency mechanism entitling identified third parties to have rights under the charter party. For example, Clause 14(d) of BIMCO SUPPLYTIME 2017:

'Himalaya clause – All exceptions, exemptions, defences, immunities, limitations of liability, indemnities, privileges and conditions granted or provided by this Charter Party or by any applicable statute, rule or regulation for the benefit of the Charterers shall also apply to and be for the benefit of the Charterers' Group and their respective underwriters.

All exceptions, exemptions, defences, immunities, limitations of liability, indemnities, privileges and conditions granted or provided by this Charter Party or by any applicable statute, rule or regulation for the benefit of the Owners shall also apply to and be for the benefit of the Owners' Group and their respective underwriters; the Vessel and its registered owners; and the Crew.

The Owners or the Charterers shall be deemed to be acting as agent or trustee of and for the benefit of all such persons and parties set forth above, but only for the limited purpose of contracting for the extension of such benefits to such persons and parties'.

Procurement contracts in the oil and gas industry, or charters in the shipping industry, that do not include these standard carve outs to the boilerplate exclusion of third party rights will have the effect of displacing the principle of transferred loss, such that a party to a contract cannot claim losses on behalf of third parties.

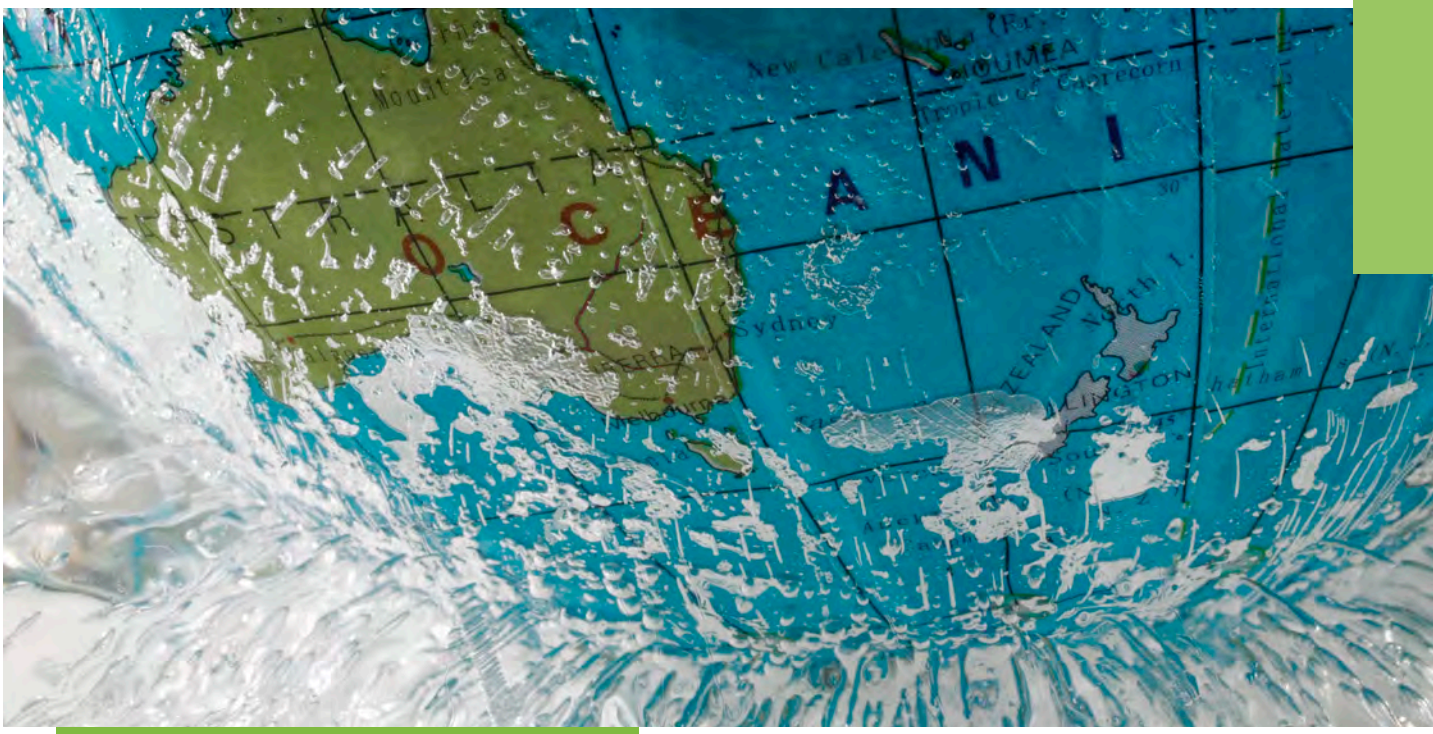
An example commonly encountered in the oil and gas industry (including a number of operators' standard contracts) concerns contracts where the operator is not acting as agent for the joint venture in contracting with the supply chain and there is not a specific clause allowing it to claim co-venturers losses in the supply chain contract. This could leave the operator in the invidious position of not being able to claim losses caused to its co-venturers by a contractor under a procurement contract and, at the same time, potentially facing claims from the co-venturers that it is in breach of the JVA/JOA obligation to ensure that the supply chain contract permits co-venturers to have rights under the contract.

The potential exclusion of the 'transferred loss' principle through boilerplate third party language makes it more important than ever that the usual precautions are put in place. Parties should therefore give careful thought to the contractual structures agreed for a given project or development and ensure that black holes are avoided through the use of appropriately worded development agreements.

Judge: HHJ Russen QC.

Chapter 4

Environment, Social and Governance



The past twelve months have seen a series of Court decision that will have a significant impact on the environmental, social and governance responsibilities and liabilities of oil companies. The exponential growth in such cases demonstrates the central role of ESG to legal risk management:

— In *Petition of Greenpeace Ltd for Judicial Review* [2020] CSOH 88 the Outer House refused Greenpeace judicial review. However, the issue is unlikely to end at this point.

— In *Okpabi v Royal Dutch Shell Plc* [2021] UKSC 3 the Supreme Court suggested that parent companies may be liable in tort to third parties should they take an active role in managing the activities of their subsidiaries.

— In *Vereniging Milieudefensie et al. v Royal Dutch Shell plc* ECLI:NL:RBDHA:2021:5339 the Dutch District Court issued a landmark decision seeking to make an individual company directly responsible for implementing the Paris Climate Change Accord.

— In *Begum v Maran (UK) Ltd* [2021] EWCA Civ 326 the Court of Appeal opened the door to potential liability to workers injured in scrappage or decommissioning yards abroad.

Greenpeace's petition for judicial review of consent to an offshore field development refused

In the *Petition of Greenpeace Limited for Judicial Review* [2020] ScotCS COSH 88 the Outer House refused permission to Greenpeace (the '**petitioner**') to bring a petition for judicial review against the Secretary of State for Business Energy and Industrial Strategy ('**BEIS**') and the OGA (the '**respondents**'). The petition sought to challenge the OGA's consent to an offshore field development project (the '**Development Project**') and BEIS' agreement to that consent. The petitioner also sought a court declaration that the Offshore Petroleum Production and Pipe-lines (Assessment of Environmental Effects) Regulations 1999 (the '**1999 Regulations**') failed to fully transpose the Environmental Impact Assessment Directive (the '**EIA Directive**').

Facts

The offshore licence for the field in which the Development Project is situated requires consent to be sought for drilling for oil. This consent is granted by the OGA. However, the application for consent must also be accompanied by an environmental impact assessment ('**EIA**') which is considered by BEIS. Once BEIS has reviewed the EIA and provided approval to the OGA, the OGA then decides whether or not to grant consent to the licence holder(s). The OGA is primarily concerned with the technical and financial issues in question, rather than environmental issues – the latter are for BEIS to consider.

The petitioner used two separate processes to challenge the decision.

One is a statutory challenge to the grant of field development consent under the 1999 Regulations. There is a procedure under Regulation 16 which provides a basis for an aggrieved party to apply to the Court for an order quashing consent in respect of such a development project.

The other process was an application for judicial review which the petitioner brought, as it was concerned that its statutory challenge would fail because the 1999 Regulations had failed to properly implement the EIA Directive.

In particular, the petitioner was concerned that, because the 1999 Regulations fail to transpose the EIA Directive and as there is no mention of the EIA Directive in Regulation 16, the Court would be confined to considering the statutory challenge in terms of the 1999 Regulations alone. That could mean that the petitioner would be denied the opportunity to challenge BEIS' decision on the EIA, because Regulation 16 does not refer to the EIA Directive.

Decision

The Outer House disagreed with the petitioner. It decided that there was nothing to prevent a petitioner seeking to make such a challenge under Regulation 16; insofar as the 1999 Regulations fail to implement the EIA Directive, the EIA Directive would have had direct effect and therefore the Court would apply the terms of the EIA Directive in any action under Regulation 16. That means there is no need for the petitioner to be concerned about the failure to fully implement the EIA Directive in the 1999 Regulations.

The Outer House also considered whether an appeal under Regulation 16 (which provides for applications in connection with the '*grant of consent*') may relate to both the agreement of the Secretary of State for BEIS and the consent of the OGA, or has a narrower scope so that it allows challenge only to the OGA consent itself (which would then exclude the EIA considerations). It was decided that the agreement of BEIS is such an integral part of the consent process that it is '*a condition precedent to the OGA granting consent*'. The BEIS decision dealt with precisely the environmental issues that the 1999 Regulations were designed to address and therefore it would be incoherent if any challenge under Regulation 16 could not address the BEIS decision as well as the OGA decision. The petitioner therefore had to be able to challenge the BEIS decision as well as the OGA decision in its Regulation 16 application and, indeed, BEIS appears to have conceded this point.

Consequently, since the issues which the petitioner was concerned about in relation to its statutory appeal mechanism (namely the fact that the EIA Directive had not been fully implemented and the assertion that the BEIS decision could not be challenged under Regulation 16) were not going to materialise then the judicial review was unnecessary – the petitioner could simply proceed with its statutory appeal.

Comment

The Scottish action followed on from judicial review proceedings in the High Court in England, which were settled by way of a consent order and in connection with which the Secretary of State for BEIS accepted that the 1999 Regulations failed to properly transpose the EIA Directive into UK law. As a result, there has been a consultation as part of a review of the 1999 Regulations and the implementation of the EIA Directive, which concluded with the Offshore Oil and Gas Exploration, Production, Unloading and Storage (Environmental Impact Assessment) Regulations 2020 ('**2020 Regulations**') being implemented on 31 December 2020 and replacing the 1999 Regulations. These Regulations ensure full transposition of the EIA Directive in respect to offshore oil and gas and projects. They also introduce new inspection, investigation and civil sanction provisions to further enhance the EIA regulatory regime for offshore hydrocarbon projects.

There have been a number of attempts in recent years by environmental groups to bring challenges to regulatory decisions in the oil and gas industry through court proceedings. They have had some, although not universal, success. Although this particular application for permission to proceed by way of judicial review was unsuccessful, it seems likely that these groups will continue to bring these issues before the courts and regulators and industry companies will need to continue to be ready to respond.

Judge: Lord Boyd of Duncansby.

Parent company liability

In *Okpabi and others v Royal Dutch Shell Plc and another* [2021] UKSC 3 the Supreme Court provided guidance to parent companies on how they might owe a duty of care to third parties and, therefore, be potentially liable in negligence for their subsidiaries' overseas operations. Alongside a number of other recent cases, the Supreme Court's decision is indicative of a broader judicial trend whereby English courts appear to be expanding duty of care principles.

Facts

In summary, members of the Ogale community (the '**Claimants**') in Nigeria commenced proceedings in the Technology and Construction Court ('**TCC**') for damages against parent company Royal Dutch Shell ('**RDS**') and operating subsidiary Shell Petroleum and Development Company of Nigeria Ltd ('**SPDC**'), alleging serious ongoing pollution and environmental damage caused by oil spills from SPDC's pipelines.

The claim against Nigerian-domiciled SPDC could only proceed in England, however, if jurisdiction could be established with English-domiciled RDS qualifying as an 'anchor defendant'. The Claimants therefore had to prove that there was 'a real issue' between the Claimants and RDS *'which it is reasonable for the court to try'*. To do so, they had to prove an arguable duty of care owed by RDS to the Claimants.

At first instance, the TCC held that there was no such duty of care owed by RDS. The Claimants had not satisfied the tripartite Caparo test of reasonably foreseeable damage, proximity, and reasonableness (failing on the second and third limbs). In February 2018, that decision was upheld by a majority of the Court of Appeal, with Sales LJ delivering a dissenting judgment.

Decision

The UK Supreme Court overturned the decisions of the lower courts. In reaching that conclusion, the Supreme Court relied heavily on its earlier judgment in *Vedanta Resources PLC and another v Lungowe and others* [2019] UKSC 20. The Supreme Court concluded that the claimants had shown that there was a real issue to be tried against RDS, and the claim will now proceed to a trial on the merits against RDS and SPDC.

The appeal before the Supreme Court raised two important issues:

1. Whether the majority of the Court of Appeal materially erred in law, in particular in its analysis of:

   (a) The principles of parent company liability in its consideration of the factors and circumstances that may give rise to a duty of care.

   (b) The procedure for determining the arguability of the claim at an interlocutory stage.

   (c) The overall analytical framework for determining whether a duty of care exists in this type of case, and the reliance on the threefold test espoused in *Caparo Industries plc v Dickman* [1990] 2 AC 605.

2. If the Court of Appeal had erred in law, whether the Claimants had an arguable case that a UK domiciled parent company owed them a common law duty of care so as to properly found jurisdiction against a foreign subsidiary company as a necessary and proper party to the proceedings.

Principles of Parent Company Liability

The Supreme Court emphasised that there is no limiting principle that *'a parent company could never incur a duty of care in respect of the activities of a particular subsidiary merely by laying down group-wide policies and guidelines, and expecting the management of each subsidiary to comply with them'*.

Rather, liability will turn on the extent to which and the way in which the parent avails itself of the *'opportunity to take over, intervene in, control, supervise or advise the management of the relevant operations… of the subsidiary'* (*Vedanta Resources PLC and another v Lungowe and others* [2019] UKSC 20, para 49). As a result, each case will be fact specific.

Control was deemed by the Supreme Court to be just a starting point. The issue is the extent to which the parent did take over or share with the subsidiary the management of the relevant activity. By way of example, the Supreme Court commented that a parent company may incur the relevant responsibility to third parties if, in published materials, it holds itself out as exercising that degree of supervision and control of its subsidiaries, even if in fact it does not do so.

Interlocutory stage

The Supreme Court concluded that the Court of Appeal had erred in law in terms of the procedure for determining the arguability of the claim at an interlocutory stage. The Supreme Court found that each of the lower courts had, incorrectly, embarked on a mini-trial which caused them to make determinations in relation to contested factual evidence that were inappropriate to make in an interlocutory application. Importantly, the Supreme Court commented that the analytical focus should be on the Particulars of Claim and whether, on the basis of the alleged facts, the cause of action asserted has a real prospect of success. Save in cases where allegations of fact are demonstrably untrue or unsupportable, it will be inappropriate for a defendant to dispute the facts alleged by adducing evidence of its own.

Further, the Supreme Court held that the Court of Appeal had wrongly dismissed the relevance of future disclosure and whether there were reasonable grounds for believing that a fuller investigation of the facts may add to or alter the evidence relevant to the issue, particularly the disclosure of internal corporate documents.

Duty of care

The Supreme Court concluded that it was *'wrong'* for the lower courts to analyse the case by reference to the threefold test in *Caparo Industries plc v Dickman* [1990] 2 A.C. 605. Following *Vedanta*, it was determined that the law relating to the liability of parent companies in relation to the activities of their subsidiaries is not a distinct category of liability in common law negligence. It gives rise to no novel issues of law and is to be determined on ordinary, general principles of the law of tort regarding the imposition of a duty of care.

Arguable case

The Supreme Court held that there is a real issue to be tried in relation to RDS's potential duty of care to the claimants. The approach of Sales LJ in the Court of Appeal was adopted, with the Supreme Court noting that the Shell group is organised along business and functional lines, as opposed to corporate status.

Comment

The outcome of this case will be a cause of concern for international oil and gas companies. The decision confirms that a parent company may be liable for the actions of an operating subsidiary. Further, it is not necessary for a claimant to show 'control' to establish a claim. The relevant issue is the extent to which the parent did take over or share with the subsidiary the management of the relevant activity.

The Supreme Court's approach suggested a willingness to look beyond corporate structure alone, and investigate how a company group is managed in practice. As a consequence, companies should consider carefully the extent to which they are able, in fact, to direct the actions (or do, in fact, direct actions) of their operating subsidiaries where this might give rise to claims in tort from third parties.

Oil and gas groups might also be well advised to consider whether any emergency response planning might have the unintended impact of spreading potential tortious liability to other group members.

In addition, the decision in *Okpabi* appears to be another example of the English appellate courts showing willingness to extend the law of negligence. For example, the Court of Appeal's judgment in *Begum v Maran* [2021] 3 WLUK 162 has reaffirmed that there is an arguable case for the English former owners of a ship to answer in refusing to strike out the claim of a Bangladeshi widow whose husband had been killed whilst dismantling a ship in the Bangladeshi shipbreaking yards in Chittagong. In its judgment in *Begum*, the Court of Appeal emphasised that this area of tort law was a novel and rapidly developing one.

Whether *Okpabi* and *Vedanta* signal a settled direction for the English courts readily accepting jurisdiction waits to be seen but the decision in *Muncipio De Mariana & Ors v BHP Group Plc* [2020] EWHC 928 (TCC) is a warning that the English courts will not always jump to the assistance of overseas claimants.

Judges: Lord Hodge JSC, Lady Black JSC, Lord Briggs JSC, Lord Kitchin JSC, Lord Hamblen JSC.

The impact of a revolutionary Dutch climate change judgment on companies worldwide

In *Vereniging Milieudefensie & ors v Royal Dutch Shell plc* C/09/571932 / HA ZA 19-379 the Hague District Court rendered a revolutionary climate change judgment with potentially significant impact on companies worldwide, especially on their environmental footprint policy. The Dutch Court decided that a multinational company was directly responsible for climate change on the basis of a duty of care following from international treaties such as the UN Guiding Principles and Paris Climate Agreement. As a result, Royal Dutch Shell ('**RDS**') has the obligation to reduce its group's CO2 emissions by 45% to meet their reduction goals to prevent climate change.

Facts

A Dutch climate change litigation wave has reached the court rooms, after the Netherlands became a frontrunner in holding a national government accountable for reducing emissions.

On 20 December 2019, the Dutch Supreme Court ruled in the landmark case *The State of the Netherlands (Ministry of Infrastructure and the Environment) v Urgenda Foundation* ECLI:NL:HR:2019:2006 that the Dutch Government must reduce emissions immediately in line with its human rights obligations. The pressure group Urgenda (Urgent Agenda), used Article 2 (right to life) and Article 8 (right to family life) of the European Convention on Human Rights ('**ECHR**') to bring a claim against the Dutch Government on the basis that there was a real and imminent threat that required the State to take precautionary measures. The Dutch Supreme Court confirmed decisions of the two lower courts, namely that the Dutch Government was *'acting unlawfully by failing to pursue a more ambitious reduction of greenhouse gas emissions'* and that it must reduce emissions emitted in the Netherlands by at least 25% by the end of 2020.

A collective legal action was brought by Friends of the Earth Netherlands (Milieudefensie) together with 17,000 co-plaintiffs and six other organisations. According to Milieudefensie, RDS has a duty to contribute to the prevention of dangerous climate change via the corporate policy it determines for its group and its entire value chain. This duty of care was substantiated by Article 2 and Article 8 of the ECHR and soft law instruments such as the UN Guiding Principles on Business and Human Rights ('**UNGP**').

Decision

The District Court ruled that RDS was responsible for its overall group policy and needs to observe a certain duty

of care regarding emissions and climate change policies. The Court ruled that Milieudefensie could not invoke rights under the ECHR directly, but in interpreting the specific duty of care applicable in this context, the Court followed the UNGP. The Court concluded that the group's policy is most likely insufficient to meet the 45% reduction standard. Since the violation of the unwritten standard of duty of care is clear, the Court ordered that RDS must comply with the reduction standards by 2030. The oil company's sustainability policy was found to be insufficiently '*specific*' by the Dutch Court.

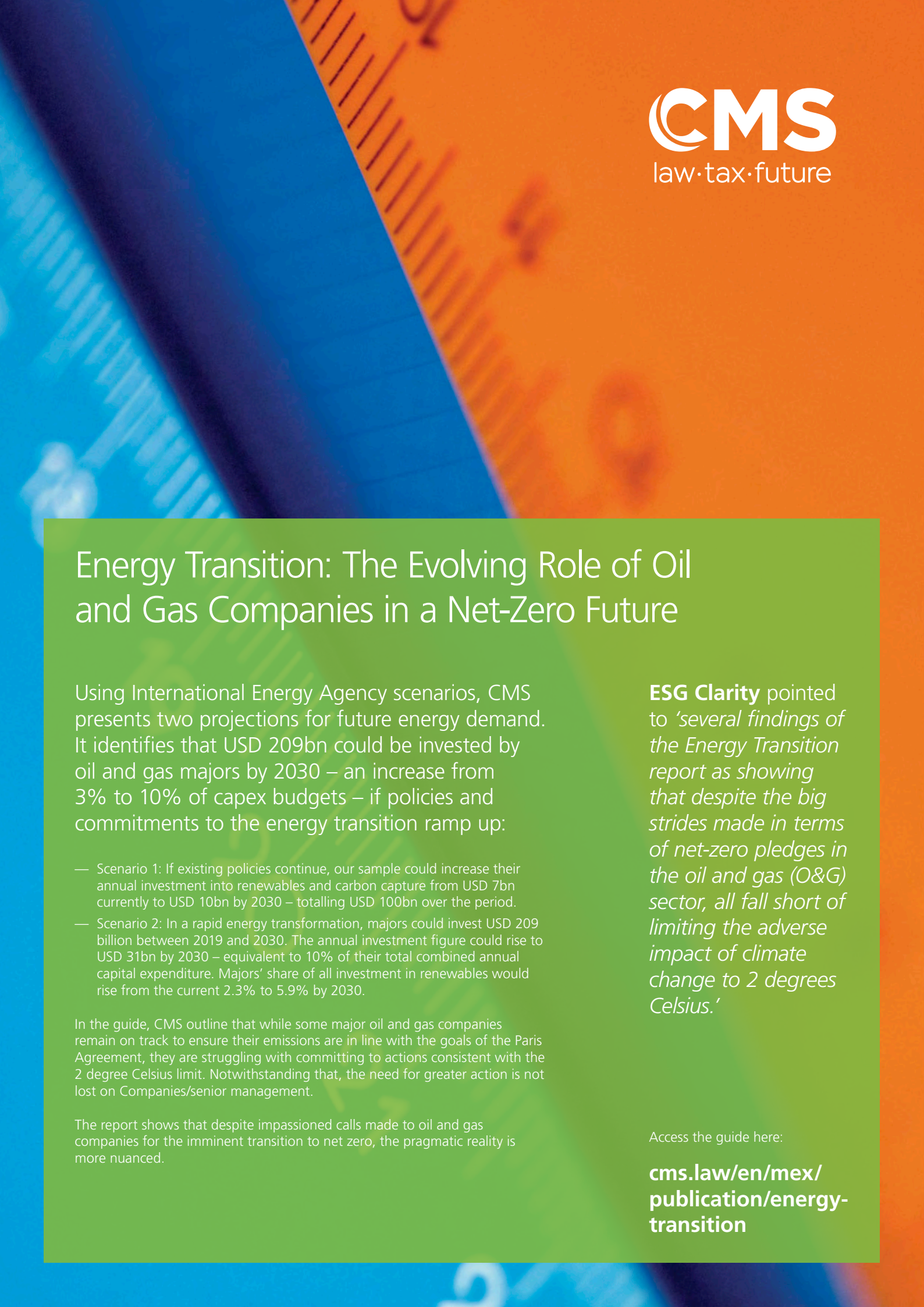
Comment

At the moment of writing, RDS announced that it probably will appeal. RDS emphasised that it takes all reasonable efforts to be CO2 neutral in 2050, but that it now needs to speed up this process.

That said, this case is the first time a court has ordered a large corporation to comply with the Paris Climate Agreement. It may have major consequences for other companies in the energy sector and beyond. This unprecedented ruling will have wide implications for the energy industry as well as for multinational companies in other sectors. This climate change judgment may act as a precedent and firm basis for further climate change litigation against multinational companies in the Netherlands and in other jurisdictions.

The decisions of the Dutch courts raises questions beyond the law. Specifically, when is it for the courts to intervene in environmental issues and when should the issue be one for Parliament or other organs of the state? In the context of the deeply felt nature of the issues involved, it seems likely that courts in a variety of jurisdictions will be asked to decide the extent to which it is for the law to enforce climate change measures against companies and individuals (independent of national legislation) and the extent to which requirements on companies and individuals need the involvement of other state organs.

Judges: Mr. L. Alwin, Mr. I.A.M. Kroft, Mr. M.L. Harmsen.



Energy Transition: The Evolving Role of Oil and Gas Companies in a Net-Zero Future

Using International Energy Agency scenarios, CMS presents two projections for future energy demand. It identifies that USD 209bn could be invested by oil and gas majors by 2030 – an increase from 3% to 10% of capex budgets – if policies and commitments to the energy transition ramp up:

- Scenario 1: If existing policies continue, our sample could increase their annual investment into renewables and carbon capture from USD 7bn currently to USD 10bn by 2030 – totalling USD 100bn over the period.
- Scenario 2: In a rapid energy transformation, majors could invest USD 209 billion between 2019 and 2030. The annual investment figure could rise to USD 31bn by 2030 – equivalent to 10% of their total combined annual capital expenditure. Majors' share of all investment in renewables would rise from the current 2.3% to 5.9% by 2030.

In the guide, CMS outline that while some major oil and gas companies remain on track to ensure their emissions are in line with the goals of the Paris Agreement, they are struggling with committing to actions consistent with the 2 degree Celsius limit. Notwithstanding that, the need for greater action is not lost on Companies/senior management.

The report shows that despite impassioned calls made to oil and gas companies for the imminent transition to net zero, the pragmatic reality is more nuanced.

ESG Clarity pointed to *'several findings of the Energy Transition report as showing that despite the big strides made in terms of net-zero pledges in the oil and gas (O&G) sector, all fall short of limiting the adverse impact of climate change to 2 degrees Celsius.'*

Access the guide here:

cms.law/en/mex/publication/energy-transition

Liability in tort for scrappage and decommissioning injuries and death abroad

In *Begum v Maran (UK) Ltd* [2021] EWCA Civ 326, the Court of Appeal reaffirmed that there was an arguable case for the English former owners of a ship to answer in refusing to strike out the claim of a Bangladeshi widow whose husband had been killed whilst breaking up the ship in the Bangladesh shipbreaking yards in Chittagong. The decision of the Court of Appeal has obvious significance for owners decommissioning vessels and infrastructure.

Facts

The claimant was the widow of a Bangladeshi shipyard worker killed in a workplace accident at the Chittagong beach breaking yards. It was accepted that the working conditions in Chittagong were dangerous. The widow, herself a Bangladeshi resident and national, chose not to sue the shipyard owners but to sue the former owners of the ship, formerly the Maran Centaurus, being broken up.

The ship had been sold at the end of its life to a Singapore cash buyer, it had been reflagged and renamed 'the Ektar'. The ship made its final voyage to Chittagong where it was sold to the scrapping yard and was broken up on the beach. Whilst the defendant had no control over the shipyard, it was not party to the sale nor to the subsequent sales, it was assumed that for the purposes of the application that the defendant knew that the ship would make its way to Bangladesh for breaking up as opposed to one of the reputable Chinese or Turkish breaking yards where standards were much higher but where the breaking was more expensive.

Decision

The Court of Appeal decided that the action could proceed to a full hearing as there was an arguable, and not fanciful, case that *'the appellant could, and should, have insisted on the sale to a so called 'green yard' where proper working practices were in place'*. The Court of Appeal added that *'the appellant arguably played an active role by sending the vessel to*

Bangladesh knowingly exposing workers (such as the claimant) to the significant dangers which working on this large vessel in Chittagong entailed'. However, the Court of Appeal recognised that the claim as pleaded was *'an unusual extension'* to the law of negligence stating that the claim was at the *'forefront of the development of the law of negligence'*.

The Court of Appeal also said that the one year Bangladeshi limitation period should apply dismissing the argument that under Rome II Article 7 the three year English limitation period should apply. However, it was arguable that the Bangladeshi law caused *'undue hardship'* under Rome II Article 26 and so was incompatible with public policy.

The case was remitted back to the High Court for determination of the issues, with limitation to be tried as a preliminary issue.

Comment

Every year hundreds of vessels and oil rigs are sold to shipbreaking yards in Asia, which include some of the busiest breaking yards in the world (more than 70% of ships sold for scrap end their lives in the region). The scrap thus obtained fuels a voracious domestic requirement for steel.

The current pressures on the oil and gas market may incentivise asset owners to decommission and scrap those assets earlier than they may otherwise have done. Oil and gas companies and other vessel owners choosing to scrap their vessel may choose to sell it to a scrapping contractor, who shall take ownership of the vessel for the purposes of heading a decommissioning, recycling and scrapping supply chain.

For scrapping contractors (and, indirectly, the owners of vessels), the employment of an Asian yard can be a cheaper alternative to shipbreaking than elsewhere in the world (particularly in Europe).

However, this industry has been the subject of criticism owing to the impact it has on the health and wellbeing of its workers and the environment. For this reason, many oil and gas companies and other vessel owners will be concerned about what happens to their vessels, once they have been sold to a scrapping contractor, despite the economic advantages of using certain yards. The prime concern in this regard will be for a loss of reputation and the very real economic disadvantages this can entail.

There are a range of potential contractual protections which could be employed by a seller in its arrangements with the contractor. As it cannot be determined in advance which of the remedies may be the most useful, a seller should consider attempting to include a range of protections in order to provide a ready arsenal, should the contractor breach the contract.

Judges: Bean LJ, Coulson LJ, Males LJ.

Chapter 5

Crude and Oil Products Shipping

The Commercial Court has continued to hand down critical decisions impacting crude oil and oil products shipping, including a case on whether demurrage liquidates a claim for damages due to late delivery and whether a failure to meet a quality specification entitles a buyer to reject the cargo:

— In *K Line Pte Ltd v Priminds Shipping (HK) Co Ltd (Eternal Bliss)* [2020] EWHC 2373 (Comm) the Commercial Court decided that a demurrage clause need not liquidate a claim for a loss caused by late delivery (including arising from a change of market price).

— In *BP Oil International Ltd v Vega Petroleum Ltd & Anor* [2021] EWHC 1364 (Comm) the Commercial Court affirmed that a buyer would be entitled to return of advance where a seller was entitled to terminate the contract for the buyer's repudiatory breach.

— In *Galtrade Ltd v BP Oil International Ltd* [2021] EWHC 1796 (Comm) the Commercial Court decided that a quality specification was not a condition of contract entitling the buyer to reject the cargo.

What loss does demurrage liquidate?

In *K Line Pte Ltd v Priminds Shipping (HK) Co Ltd (Eternal Bliss)* [2020] EWHC 2373 (Comm), the Commercial Court has taken the opportunity to resolve a '*long-standing uncertainty on a point of law*' in the shipping and offshore industries. Where a vessel is delayed beyond the expiry of laytime, it is typical for demurrage to be paid. The issue the Commercial Court has sought to resolve is precisely what the demurrage rate represents, i.e. whether it is no more than a figure compensating the owner for loss of the use of the vessel or whether it also covers any claim for different kinds of loss. The issue is an important one as it can leave the door open to a claimant to bring a damages claim for other losses in addition to the demurrage claim.

Facts

The parties entered into a contract of affreightment that provided for a number of separate voyages on an amended Norgrain form. The Owners nominated the *Eternal Bliss* for a June 2015 laycan, loading 70,133 m.t. of soybeans at Tubarao for discharge in China. Loading was completed and bills of lading issued on 11 June 2015.

The *Eternal Bliss* arrived at the discharge port anchorage and tendered a NOR on 29 July 2015. However, she was kept at the anchorage for about 31 days due to port congestion and lack of storage space ashore for the cargo.

Discharge only commenced on 30 August. As is the terrible fate with many, the perishable cargo was found to have suffered mould damage and caking. After posting security in favour of receivers as security for their cargo claim, the vessel sailed away on 11 September 2015. The Owners settled the receivers' claim for c.USD 1.1m and then sought to recover this cost from the Charterers.

The Commercial Court was asked a question of law for determination: whether, in addition to paying demurrage, the Charterers were also in principle liable to compensate the Owners for other losses by way of damages for breach in failing to complete discharge within the permitted laytime. In other words: *'[t]he main point of principle asks what is it that demurrage liquidates'.*

Decision

The Owner of the *Eternal Bliss* did not allege a breach by the Charterer other than a failure to discharge within the laytime.

The Charterer argued, in turn, that the Owner's claim was only one for detention of the vessel because the cargo damage arose from the delay of the vessel. The Commercial Court dismissed this argument, holding that the damage to the cargo was quite distinct in nature from – and additional to – the detention of the vessel.

Therefore, the Commercial Court had to consider whether, if damages in addition to demurrage were to be recovered, it was necessary to show breach of a separate obligation as well as damage of a different kind of delay in completing discharge.

The Commercial Court referred to the Court of Appeal decision in *Reidar v Arcos* [1927] 1 KB 352, where it was decided that recovery was possible even if an extra breach is caused by a failure to complete the discharge within the laytime. While the majority thought that there were two breaches and the minority thought that

there was only one, this did not mean the Owners' claim for damages would have necessarily failed had it been unanimously concluded that there was only one breach.

However, *The Bonde* [1991] 1 Lloyd's Rep 136 was authority for the proposition that an additional and different breach was necessary to recover damages beyond demurrage.

The Commercial Court noted that it was not bound by *The Bonde* itself as this is a first instance decision, and declined to follow that decision.

The Commercial Court decided that the demurrage rate was intended to be an agreed measure of the value of the ship's lost time – but no more than that. The Commercial Court decided: *'I do not think it would occur to commercial parties unaware of the case law that agreeing a demurrage rate liquidated, for example, claims in respect of physical injury to ship, cargo or crew, as they would understand, I suggest, that the demurrage rate simply compensated the owner for the use of the ship beyond the laytime, that use not being paid for by the freight'.*

Therefore, the Commercial Court rejected the suggestion that a demurrage rate liquidates all damages recoverable, whatever the nature of the loss suffered, in respect of a breach of the obligation to complete within the laytime. As such, the response to the question of law was that, in principle, the Owners were entitled to be compensated in respect of their losses and expenses arising out of the cargo damage claim.

To adapt a table created by the Commercial Court in this case:

Can Owners Recover Beyond Demurrage?		**Claim other than for 'detention of the vessel'?**	
		Yes	No
Separate Breach?	Yes	Recovery Possible	Recovery Not Possible
	No	The principal question in this case: Recovery Possible	Recovery Not Possible

Comment

Recognising the significance of the decision, the Commercial Court noted: *'From time to time, a case provides the opportunity to resolve a long-standing uncertainty on a point of law of significance in a particular field of commerce. This is such a case'.*

The Owners in this case were entitled in principle to be compensated by the Charterers in respect of a cargo damage claim even though the deterioration of the cargo had resulted from its continued stowage aboard after the Charterers had failed to discharge within the permitted laytime. This was the case despite the fact that there was no additional breach of the charterparty by the Charterers.

The judgment is the first to consider the issue, and consider the difficulties of previous decisions dating back to *Reidar v Arcos* in 1927, in this level of detail.

In deciding not to follow *The Bonde*, perhaps considered by many to have settled the issue 30 years ago, the Commercial Court acknowledged that *'[i]t is a strong thing for a judge of first instance to refuse to follow a prior decision at first instance that has stood without direct criticism in later case law for a substantial period of time'.*

This is a significant decision for the shipping and offshore industries. Owners will now have an authority to point towards when considering how to recover losses unrelated to the vessel's earning potential (e.g. cargo deterioration) as a result of a failure to load or discharge within the laytime.

These losses might be wide ranging and include damages relating to a change in the value of the goods. The Commercial Court specifically explained that where in an f.o.b. contract a delivery date is stated, but time is not of the essence (either on the proper construction of the particular contract or because the buyer does not choose to terminate for late delivery though entitled to do so), and the seller delivers late on a falling market, the buyer will have a claim for damages for late delivery unaffected by any laytime/demurrage clause. The Commercial Court went on to explain *'There is to my mind no rational basis for saying that the position is different merely because the effectively warranted delivery date is a function of the laytime provisions rather than a delivery date separately stated as such. The idea that by agreeing also a demurrage clause, typically referable to the charterparty demurrage rate, the buyer is agreeing to forgo his normal late delivery claim under s.53 of the Sale of Goods Act 1979 is startling and, in my respectful view, not at all likely to be the intention of traders agreeing f.o.b. sales'.* It goes without saying that absent an express exclusion of such losses, the Commercial Court decision opens the way for significant claims.

The judgment contains a thorough and comprehensive examination of the case law. The response to the question: *'what does demurrage liquidate?'* in this context could now be said to be that it liquidates delay and use of vessel claims, but not others caused by the delay.

As noted at the start of his discussion, Baker J made the *'obvious point'* that parties to a contract could use language in their demurrage clause that answers the issue in this case. As with many standard forms (including Asbatankvoy and Gencon), the Norgrain form does not contain such language. Parties would need to make an amendment to the form to address the issue in this case. In addition, a claimant must still prove that there is the necessary link of causation between the breach and the losses claimed.

The Charterers have appealed, with the appeal being listed for 27 or 28h October 2021. A decision from the Court of Appeal, in the light of conflicting High Court authorities, will be welcomed. In the meantime, charterers under existing arrangements may potentially be exposed to greater losses than they had considered, should they overrun the allowed laytime.

Judge: Baker J.

Give me my money back!

What happens when a seller terminates an oil sale agreement for buyer default after the buyer has made payment, but before lifting? Is the buyer entitled to its money back, or does the buyers default relieve the seller of any obligation? The Commercial Court considered this issue in *BP Oil International Ltd v Vega Petroleum Ltd & Anor* [2021] EWHC 1364 (Comm). The Commercial Court's decision will be of general interest to parties to crude oil and oil products sale and purchase agreements.

Facts

BP Oil International Ltd ('**BPOI**') is part of the BP Group, and operates as a trading entity within that group. Dover Investments Limited ('**Dover**') had acquired interests in the Gebel El Zeit Concession in Egypt in the late 1990s, and subsequently sold part of those interests to Vega Petroleum Limited ('**Vega**') in October 2012. Over many years, BPOI contracted to purchase crude oil from Dover and Vega (and their predecessors) in a series of contracts (the '**Contracts**') which were, broadly speaking, on similar terms. From 2010 onwards the Contracts incorporated BPs General Terms and Conditions ('**GTCs**'). The Contracts had broadly similar delivery terms, such as:

'6. DELIVERY

Delivery shall be given and taken FOB RAS SHUKHEIR TERMINAL.

At the Buyer's option delivery can be given and taken FIP at the inlet flange of the SUMED system in AIN SUKHNA REGION EGYPT. However such option shall be mutually agreed between Buyer and the Seller, provided that such option shall not result in any additional expense or delay in payment to the Seller'.

The delivery clause therefore offered BPOI two options: Classic FOB delivery at Ras Shukheir, or an option to take delivery FIP into the SUMED pipe system at Ain Sukhna.

Over time a number of obstacles prevented BPOI from arranging to uplift the crude oil from the terminal – for example, it was necessary to wait until several months' production had accumulated before there was sufficient quantity to lift, a vessel then had to be arranged and various approvals and authorisations were also required.

In the event, BPOI was unable to lift in full the quantity of crude oil for which it had paid and, after a period of abortive attempts to negotiate a resolution, BPOI raised proceedings for repayment of USD17,235,448 that it had paid to Dover and Vega for the purchase of a total of 211,837 barrels of Gulf of Suez Mix crude oil ('**GOSM**').

BPOI's primary claim was for restitution based on unjust enrichment, seeking return of the amount paid for GOSM that it had not received. The main issue before the Court was whether the payments BPOI made entitled it to delivery of the GOSM in such a way that, if those were not delivered, BPOI was entitled it to its money back; or whether the payments made were in fact to acquire a right to lift certain quantities of oil and as such were unconditional payments, so that BPOI had no claim for recovery of payments made even if BPOI chose never to lift the relevant quantity of oil in full.

By way of refresher, a claim for unjust enrichment is an equitable remedy in restitution that sits outside the terms of a contract – it does not serve to imply terms into a contract and, indeed, does not rely upon the existence of any contractual relationship. It serves to restore to an innocent party a gain which someone else has obtained from them. It is most commonly claimed where a payment has been made or transferred to someone else by mistake and, in essence, applies where a party can demonstrate that:

1. The party ('**B**') against whom the claim is made has been enriched;

2. they have been enriched at the expense of the party making the claim ('**A**'); and

3. it is unjust for B to retain the enrichment.

BPOI asserted that, in order to succeed, it required simply to demonstrate that:

— There had been a total failure of consideration; and

— the Contracts had terminated.

Dover and Vega (the '**Defendants**') challenged the claim on a wide range of grounds, which required the Court to consider in some detail the proper approach to construction of the Contracts as well as issues arising from the claimed factual matrix.

Decision

The key issues relevant to the unjust enrichment claim which the Court required to address were:

1. Questions of construction as to the true nature of the Contracts; and

2. whether any of the various grounds on which the Defendants relied were made out, including

    a. whether there was a total failure of the basis for BPOI's payments to Vega and Dover under the Contracts, or whether these only provided an option to lift; and

    b. whether BPOI was estopped from contending that Vega failed to deliver the GOSM.

The true nature of the Contracts

BPOI contended that the Contracts were simply contracts for sale and purchase FOB of crude oil; in contrast, Dover and Vega argued that they were modern commercial contracts with (i) substantial duration and detailed provisions and (ii) various features that were inconsistent with BPOI having a right to demand repayment. As such, Dover and Vega asserted that both BPOI and the Defendants understood the payments to be unconditional, such that BPOI had no option to recover those payments once made.

The Commercial Court considered that Contracts plainly on their face provide for FOB delivery. Furthermore, that FOB designation is effectively multi-layered, reflected through not just the Contract but via the documents to which it referred. Thus:

a. There were two explicit and matching mentions of FOB conditions in the Contracts. Clause 5 provided *'The quantity of Oil to be sold and delivered by the Sellers FOB to Buyer'*, Clause 6 provided *'Delivery shall be given and taken FOB RAS SHUKHEIR TERMINAL'.*

b. There was also the reference in Clause 9 stating the Seller's share of the Cargo in the shipping documents. Further changes were made over the years to some of the terms consistent only with FOB sales – such as the references to demurrage.

c. The section of the BP GTCs concerning FOB trades provides *'the risk and property in the crude oil delivered under the Agreement shall pass to the Buyer as the crude oil passes the Vessel's permanent connection at the Loading Terminal'* (section 2.1).

d. Incoterm A4 required the Defendants to deliver the GOSM *'on board the vessel nominated by'* BPOI with risk in the GOSM passing when it *'passed the ship's rail at the named port of shipment'.*

The term FOB is one which is thoroughly well known to and understood by everyone who operates in the world of contracts for the international sale and carriage of goods. It is a term which can be seen to have been in use since the nineteenth century. It is useful to merchants to know what that means. The obligations of an FOB seller are trite law:

a. Benjamin's Sale of Goods (11th ed) explains at §20-30: *'It is the duty of an f.o.b seller to put the goods on board a ship nominated or designated by the buyer… The place at which the goods are thus delivered is considered to be the place of performance under an f.o.b contract'.*

b. Bridge, The International Sale of Goods (4th ed.) at §3.04: *'Since delivery occurs when the goods are placed free on board ship, the seller is bound to ensure the shipment of the goods'.*

The Commercial Court then moved to test that initial view against the factual matrix (making in the process some criticism of the Defendants, as they had not properly pled a factual matrix on which to base the points they made). The Commercial Court concluded that, when considered more closely, the Defendants had '*oversold*' the true position in their submissions and had ignored various genuine factual matrix points that operated in BPOI's favour. Summarising the conclusions of the analysis the Commercial Court explained:

'[173] There is therefore in my judgment essentially nothing in the aggregate which pulls against the natural reading of the words in any way. But in addition, even if there were more 'heft' to the factual matrix evidence it is not enough that such evidence creates some sort of tension with the plain reading of the contract. There must – as the authorities make crystal clear – be a route to the construction contended for. The authorities are also clear that if the words are unambiguous the court must honour them. The Defendants would need to show first that their factual matrix creates the necessary ambiguity and then demonstrate a way of arriving at the reading of the contract for which they contend based on the composite of the wording and the factual matrix – presumably by some sort of implied term. This is because at the end of the day what the Court is doing is not optimising the contract with the benefit of hindsight but saying how the reasonable person in the parties' shows would read that contract in the light of the documents and the other relevant facts…

[178] I conclude without any hesitation that the Defendants' case on construction must fail. As BPOI submitted, it appears convoluted and extremely uncommercial to the eye of a commodities lawyer; but even putting that to the side and road testing it against first principles, it proves to be simply impossible to reach the pleaded construction in any acceptable way'.

Total failure of the basis for BPOI's payments

BPOI's claim in unjust enrichment was based on the assertion that it had received no consideration whatsoever – a remedy expressly preserved in Section 54 of the Sale of Goods Act 1979 which provides:

'Nothing in this Act affects the right of the buyer…to recover money paid where the consideration for the payment of it has failed'.

Benjamin confirms that the remedy of restitution is available in the case of a failure to deliver:

'Where, after the buyer has paid the price (or part of it) to the seller, the seller fails to deliver the goods…he may either sue for damages, or for restitution of the money paid to the seller…If he sues for restitution, he can avoid the rules of damages, since his claim is for return of the precise sum of money which he paid to the seller, but he must terminate the contract'.

It was common ground between the parties that the Defendants had neither delivered the GOSM nor repaid any amount to BPOI.

However, the Defendants argued that there was not a complete failure on the basis that:

1. The Defendants were required in terms of the Contracts to undertake extensive actions before BPOI was to lift, or could lift, any oil - for example, they had to inform BPOI of the estimated volume available for lifting, give an initial best estimate and to agree with GUPCO actual monthly volumes to which BPOI became entitled; and
2. BPOI received significant benefit in the entitlement which accrued to it to lift the relevant amounts.

However, the Commercial Court was not persuaded on either ground: It considered that all of the terms on which the Defendants relied were merely administrative provisions rather than speaking to the substance of the Contracts; the assertion that the accrual of an entitlement to lift was a benefit was simply a re-working of the Defendants' (failed) arguments on the nature and true construction of the Contracts, and so also unpersuasive. An '*entitlement to lift*' was worthless if it could never be realised and so did not represent the intended consideration, i.e. actual delivery.

The Commercial Court had, however, agreed with the Defendants that BPOI had wrongfully terminated the Contracts - it found that BPOI raising proceedings was a repudiatory breach which the Defendants had then accepted as terminating the Contracts. The Defendants asserted that it would be wrong as a matter of principle to allow BPOI to rely on its own repudiatory breach of contract to find a claim in unjust enrichment based on a total failure of consideration in the circumstances of this case. However, that argument was also unsuccessful,

with the Commercial Court pointing to the reasoning in cases such as *Dies v British and International Mining and Finance Corporation Limited* [1939] 1 KB 724, where it was found that a party which repudiates a contract of sale by refusing to accept goods may nonetheless recover the price paid in unjust enrichment.

The Defendants had also alleged that BPOI was estopped by convention from arguing that the Defendants had not delivered the product. This was dismissed due in no small part to the no oral agreement provision in the BP GTCs and the Supreme Court's decision supporting such provisions in *WB Business Exchange Centres Ltd v Rock Advertising Ltd* [2019] AC 119.

With these defences all rejected, BPOI's claim for restitution was allowed in full.

Comment

The Commercial Court's decision affirms some useful points for those involved in the trading, drafting and administration of crude oil and oil products sale and purchase agreements:

1. Where a contract is expressly stated to be FOB it is trite law that it is the duty of the seller to put the goods on board a ship nominated or designated by the buyer. Further, the place at which the goods are delivered is considered to be the place of performance under an FOB contract.

2. Where the buyer is given an express contractual alternative to the FOB delivery, exercisable at its option, it should not usually convert the contract into non-FOB delivery whereby the buyer is deemed to have received consideration (by way of an alternative right to mode of lifting) absent FOB delivery by the seller.

3. Further, where the seller is required to carry out certain administrative acts prior to delivery, unless expressly stated otherwise, these will rarely be considered to be a condition to its obligation to deliver such as to render the payment unconditional but the delivery of oil conditional.

4. If the express contractual terms are clearly expressed to be FOB (or, to use Cockerill J's characterisation: *'an FOB shaped transaction'*), it is unlikely that any extraneous evidence will change this position to a non-FOB contract.

5. If delivery is not made when the contract is terminated, the buyer will have suffered a total failure of consideration and be entitled to repayment of the contract price.

6. The above includes circumstances where the buyer has committed a repudiatory or renunciatory breach, and it is the seller who has brought the contract to an end.

In relation to the final point – sellers beware!

Judge: Cockerill J.

You reject if you want to, the product is not for rejection!

In *Galtrade Ltd v BP Oil International Ltd* [2021] EWHC 1796 (Comm) the Commercial Court has decided that a buyer under the BP General Terms and Conditions for Sales and Purchases of Crude Oil and Petroleum Products 2015 Edition was not entitled to reject off-specification product and, in so rejecting, was itself in breach of contract. The buyer's remedy was limited to a right (in principle) to damages for the diminution in value of the product.

Facts

By a contract for sale dated 10 October 2018 (the '**Contract**'), BP Oil International Ltd ('**BPOI**') agreed to sell four Parcels of SRFO (the '**Product**') to Galtrade Ltd ('**Galtrade**'). SRFO is *'the residual fuel oil which emerges from the primary refining of crude oil'*. Its quality and value can be affected by, amongst other things, the concentration of pollutants found in it, in particular vanadium and sulphur, which is undesirable because refineries have to incur additional cost to remove these elements during the refining process.

Galtrade raised concerns that the SRFO specifications of the third Parcel might not be as specified in the Contract. The test results would not be available until after the vessel had loaded and sailed.

The test results revealed that the sulphur content was 1.53% rather than the agreed maximum of 1.30%. Consequently, Parcel 3 did not comply with the contractual specifications. Galtrade rejected and refused to pay for Parcel 3. When the cargo arrived in Malta, BPOI agreed to take possession of Parcel 3 via ship to ship transfer, blended it with other parcels and sold it to the US instead.

The parties agreed that the product in Parcel 3 did not comply with the specifications in the Contract. Galtrade claimed damages of more than USD 1m in wasted expenditure.

BPOI admitted a breach of contract. However, BPOI contended that Galtrade had no right to reject the Product and that Galtrade was itself in breach by refusing to pay for Parcel 3.

Decision

The decision of the Commercial Court covers a number of areas of law but for present purposes the key issue was whether Galtrade was entitled to reject Parcel 3. If it was not, Galtrade would itself be in breach for wrongful rejection.

Galtrade's right to reject Parcel 3 was dependent on whether BPOI's obligation to provide Product of a certain quality was a 'condition' or an 'intermediate term' under English law. The significance of this distinction is that if the quality requirement was a condition, Galtrade would have had a right to terminate (or, in this case, reject the Product) for breach. With an intermediate term, the ability of Galtrade to terminate (or reject) for breach was a matter of interpretation of the contract and a matter of assessing the effect of the breach at the time it took place.

Were the Quality Requirements Conditions of the Contract?

The quality clause, from BP's General Terms, read:

'59.1 Quality

59.1.1 Unless otherwise stated in the Special Provisions, the quality of Product delivered hereunder shall not be inferior to the specification (if any) set out in the Special Provisions. Whether set out in these General Terms and Conditions or in the Special Provisions neither typicals nor any stipulation as to time of delivery shall form part of the Product's description, quality or fitness for purpose. This sub-section constitutes the whole of the Seller's obligations with respect to the description, quality and fitness for purpose of the Product and all statutory or other conditions or warranties, express or implied, with respect to the description or satisfactory quality of the Product or its fitness for any particular purpose or otherwise are hereby excluded' (emphasis added).

Galtrade argued, amongst other things:

— That the quality requirements of the Contract were conditions. Any deviation from the guaranteed levels of quality (whether maximum or minimum) would entitle Galtrade to reject the cargo in its entirety.

— A provision in the Contract to deliver Product meeting the agreed specification would, under the Sale of Goods Act 1979, have been considered, in its entirety, a 'term of description' rather than quality, and therefore would – but for Clause 59.1.1 – have been a statutory condition. If the intention had been to change the usual regime for a sale by description so fundamentally, Clause 59.1.1 would need to say so (and it did not).

The Commercial Court rejected these arguments for a number of reasons, including:

— The relevant obligations were not described in the Contract as conditions, nor did they specify an automatic right to reject.

— The quality parameters in the Contract were, on the expert evidence, *'pretty normal…for that type of product'*, which pointed to the provisions being standard quality specifications of the Product, not part of a sale by description.

— The specifications did not mark some clear watershed between the acceptable and the unacceptable. On the contrary, on the evidence Parcel 3 remained '*usable as a blend stock*' and still marketable (albeit less so).

— A consideration of the commercial effect of classifying the specifications as conditions would be that it would *'place significant risk on the seller and accord corresponding commercial power to the buyer'*. The commercial imbalance between the parties would be great and the consequences were sufficiently striking for the absence of an express provision entitling rejection to be of significance.

As a result, the relevant obligations were held not to be conditions; they were intermediate terms. The question then became whether the breach was sufficiently serious to generate a right to reject.

Was BPOI's Breach 'Sufficiently Serious'?
It was significant that both of Galtrade's expert witnesses agreed that Parcel 3 remained marketable at an appropriate price, notwithstanding its off-specification form. This strongly undermined the case that Galtrade was deprived of either substantially the whole benefit or a substantial part of the benefit of the Contract.

Galtrade also had alternative remedies available to it in cases where there were deviations from the contractual specifications. It was held that if differences in specification affected the price rather than whether the Product can be used at all for all or any of its intended purposes, then that was where the remedy ought in principle to lie.

As a result, it was held that BPOI's contractual breach was not of sufficient seriousness to justify the rejection. It did not *'go to the root of the contract'.*

Result
The quality requirements were intermediate terms, the breach of which were insufficiently serious to entitle Galtrade to reject the Product. As a result, Galtrade's claim for wasted expenditure was rejected. Its losses did not directly result from BPOI's breach of the Contract, rather, it resulted from Galtrade's own '*unreasonable conduct*' in '*wrongfully*' rejecting and not paying for Parcel 3.

That conduct on the part of Galtrade was itself a breach of Contract.

Comment

The Buyer's Conundrum
The case highlights the conundrum facing a buyer of product when faced with a quality issue, particularly so on the widely used BP General Terms.

As the quality requirements of the BP General Terms were not, in this case, viewed as conditions, a total rejection of a cargo or a batch could expose a buyer to a claim for wrongful rejection. Before rejecting product, a buyer should consider whether other contractual remedies, such as damages or a price adjustment mechanism (if available), would be a sufficient remedy.

Whether a right to reject accrues would be a question of contractual interpretation and an assessment of the effects of the breach.

On the facts of this case, Galtrade sought to reject a batch of SRFO with a sulphur content of 1.53%, which was above the requirement of 1.3%. On the expert evidence, the Commercial Court rejected the assertion that the higher sulphur content made the Product '*substantively different*' (indeed 1.53% and 1.3% would both have been viewed as '*intermediate sulphur*' content).

The case may have been decided differently had the Product delivered been substantively different to that required by the Contract. On the specific issue of sulphur content, on the evidence that might have been the case if the sulphur content was in excess of 3.5%.

Desirability of Flexibility in the Product Sales Market
BPOI had submitted that Galtrade's case was '*commercially absurd and would have a chilling effect on the commodities market if it were correct*'.

The Commercial Court did not endorse, nor reject, that particular submission but it did accept that the effect of Galtrade's case, as regards the balance of commercial risk between the parties, was '*simply too severe and wide-ranging for it to be left unsaid*' in the Contract.

The judgment reflects English law's hostility to classifying provisions in contract as conditions, unless the provision is clearly to that effect. The guidance of the existing case law leans in favour of intermediate terms rather than conditions, and especially so in the area of quality deficiencies.

In line with previous product sale cases, the judgment demonstrates that it is legitimate to have regard to the nature of the business which the parties were conducting and were known to be conducting. It was significant that the very business in which the parties engaged might involve the upgrading or downgrading of parcels within larger blends. This made it less likely that, within such a market, the expectation would be that a single breach of a specification parameter would automatically make the cargo vulnerable to rejection.

The Commercial Court was cognisant of the fact that in the market in which the parties operated, deviations from specification were viewed as having remediable economic consequences.

Indeed, the judgment emphasises the desirability of protecting the important attributes in the market of '*flexibility and agility*', when it comes to making the most out of cargoes which are off-specification (and indeed higher than specification).

Judge: Mr Beltrami QC.

Chapter 6

Commodity Sales

Commodity sales are core to oil and gas companies' profitability. The past twelve months have seen some decisions of significant interest:

— In *Septo Trading Inc. v Tintrade Limited* [2021] EWCA Civ 718 the Court of Appeal overturned a Commercial Court decision and decided that a quality determination term in the incorporated model terms should be disregarded as inconsistent with the 'recap'.

— In *British Gas Trading Limited v Shell UK Limited & Anor* [2020] EWCA Civ 2349 the Court of Appeal decided that no damages arose from a breach of capacity obligation under a long-term natural gas sale and purchase agreement.

— In *B A Kitchen Components Ltd v Jowat (UK) Ltd* [2021] NIQB 3 the Northern Ireland High Court decided that an exclusion of liability clause did not comply with the reasonableness requirements of the Unfair Contract Terms Act 1977.

Resolving inconsistent quality determination provisions for the sale of fuel oil

In *Septo Trading Inc. v Tintrade Limited* [2021] EWCA Civ 718 the Court of Appeal considered whether a certificate of quality for fuel oil was final and binding on the parties where the specific terms agreed said the certificate was final and binding, but the 2007 BP General Terms (incorporated) made it 'pay now, argue later'.

Facts

The Claimant, Septo Trading Inc ('**Septo**') was a buyer, and the Defendant, Tintrade Limited ('**Tintrade**'), was the seller of fuel oil that had been loaded on board the vessel 'NOUNOU'.

On 20 June 2018, the parties entered into a 'recap' which evidenced the contract for supply of 36,000 – 42,000 mt of high-sulphur fuel oil RMG 380 as per ISO 8217:2010 (the '**Recap**'). ISO 8217:2010 deals with marine fuels and provides by Clause 5.1 that the fuel shall conform to the characteristics within certain limits. In this case, the appropriate limits required that total sediment aged should not exceed 0.1%. Clause 5.2 provides that the fuel shall be *'a homogenous blend of hydrocarbons derived from petroleum refining'.*

The 'Determination of Quality and Quantity' clause in the Recap provided:

'As ascertained at loadport by mutually acceptable first class independent inspector, or as ascertained by loadport authorities and witnessed by first class independent inspector (as per local practice at time of loading). Such result to be binding on parties save fraud or manifest error. Inspection costs to be shared 50/50 between Buyer/Seller'. (emphasis added)

The clause entitled 'General' provided that the BP 2007 General Terms and Conditions ('**BP Terms**') for FOB sales applied unless they conflicted with terms of the Recap. The relevant BP Terms provides:

'1.2 Certificates of Quantity and Quality

1.2.1 Provided always the certificates of quantity and quality … of the Product comprising the shipment are issued in accordance with sections 1.2.2 or 1.2.3 below then they shall, except in cases of manifest error or fraud, be conclusive and binding on both parties for invoicing purposes and the Buyer shall be obliged to make payment in full in accordance with Section 30.1 but without prejudice to the rights of either party to make any claim pursuant to Section 26'. (emphasis added)

Joint instructions were provided by Septo to SGS Latvija Limited ('**SGS**') to perform quantity and quality determinations of the fuel oil to be shipped at the loading port selected by Tintrade. SGS took samples from a number of shore tanks in June 2018. The sample was analysed and by a certificate dated 2 July 2018 the Total Sediment Potential ('**TSP**') was stated on behalf of SGS to be 0.4% which is within the contractual specification. (TSP is a measure of how much sediment (asphaltenes) any given fuel oil will produce in long term storage). 41,335mt of cargo was loaded on board NOUNOU between 30 June and 2 July 2018.

Between 2 and 11 July 2018 the cargo was transported to Gibraltar where it was transferred to two other vessels pursuant to a contract of sale between Septo and Macoil International SA ('**Macoil**'). On 17 July 2018, Saybolt España S.A.L. issued a certificate of analysis in respect of samples drawn from one of those vessels after Macoil had received the cargo. The certificate stated that the TSP of the sample was 0.37%, being in excess of the maximum permitted TSP value under ISO 8217:2010. Samples collected by SGS prior to and during the loading of the other vessel were subsequently tested by the Inspectorate Rotterdam in the Netherlands on 31 July 2018. Its tests showed that whilst most samples from the shore tanks were on-spec, some were off-spec.

By the time the cargo had been found to be off-spec Septo had already paid the purchase price to Tintrade, but had not been paid by Macoil. Septo subsequently learned that Macoil had sold approximately 10KT of the cargo to its customers before it was found to be off-spec. After failing to persuade Tintrade to re-purchase the cargo and failing to agree a reduced price with Macoil, Septo decided to blend the off-spec cargo to produce an on-spec cargo and sell the re-blended product. Septo retrieved the 31KT of cargo remaining on board one of the vessels and the cargo was transported to Malta. In Malta the fuel oil was successfully blended with straight run fuel oil on board and Septo was able to re-sell the blended cargo.

Septo argued that the cargo delivered was off-spec and sought damages of USD 7.79m. In this respect, it argued that the effect of Clause 1.2.1 of the BP Terms was a 'pay now, argue later' provision such that it only made the certificate of quality binding for the purposes of an invoice – but did not prevent a subsequent dispute.

Although the actual loss suffered by Septo, in respect of the re-blended fuel was said to be USD 3.82m, the sum claimed as damages in respect of the total cargo was USD 7.79m.

Commercial Court Decision

Certificate of Quality

The Commercial Court considered whether Clause 1.2.1 of the BP Terms is '*in conflict*' with the 'Determination of Quality and Quantity' clause in the Recap, such that Tintrade was correct that the Recap applied and the certificate of quality was final and binding for all purposes (save for fraud or manifest error).

In *Pagnan v Tradax* [1987] 2 Lloyd's Reports 342 Bingham LJ explained that it is necessary to keep in mind that *'it is a commonplace of documentary construction that an apparently wide and absolute provision is subject to limitation, modification or qualification by other provisions. It does not make the later provisions inconsistent or repugnant'*. He went on to say: *'It is not enough if one term qualifies or modifies the effect of another; to be inconsistent a term must contradict another or be in conflict with it, such that effect cannot fairly be given to both clauses'*.

It is apparent that the Court should keep in mind that the two clauses in question are part of the same contract and that the parties chose to make the contract subject to the BP Terms. Thus, it would be wrong to approach the question of construction with any predisposition to find inconsistency between the Recap and the BP Terms. Equally, it would be wrong to approach the question of construction on the assumption that there is no inconsistency. The provision in the Recap that the BP Terms apply where there is no conflict with the terms of the Recap show that the parties accept that there may be conflict or inconsistency.

The Commercial Court concluded that Clause 1.2.1 of the BP Terms was not in conflict with the Recap. Rather, it qualified the Recap. The Recap 'Determination of Quality and Quantity' clause, had it stood alone, would have had the effect contended for by Tintrade, that is, that in any claim for breach of contract the determination of the independent inspector would be binding as to quality. But it did not stand alone. It stood together with Clause 1.2.1 of the BP Terms. That Clause could be read together with the Recap by regarding it as qualifying the otherwise general effect of the Recap by saying that the binding nature of the determination of the independent inspector was limited to questions of invoicing, without prejudice to any later claim for breach of contract.

In that way both clauses could be read together and effect could be given to both of them. Thus, Clause 1.2.1 was not in conflict with the Recap. It qualified or explained the Recap.

As a result, the certificate of quality was not final and binding and Septo was entitled to make a claim for damages.

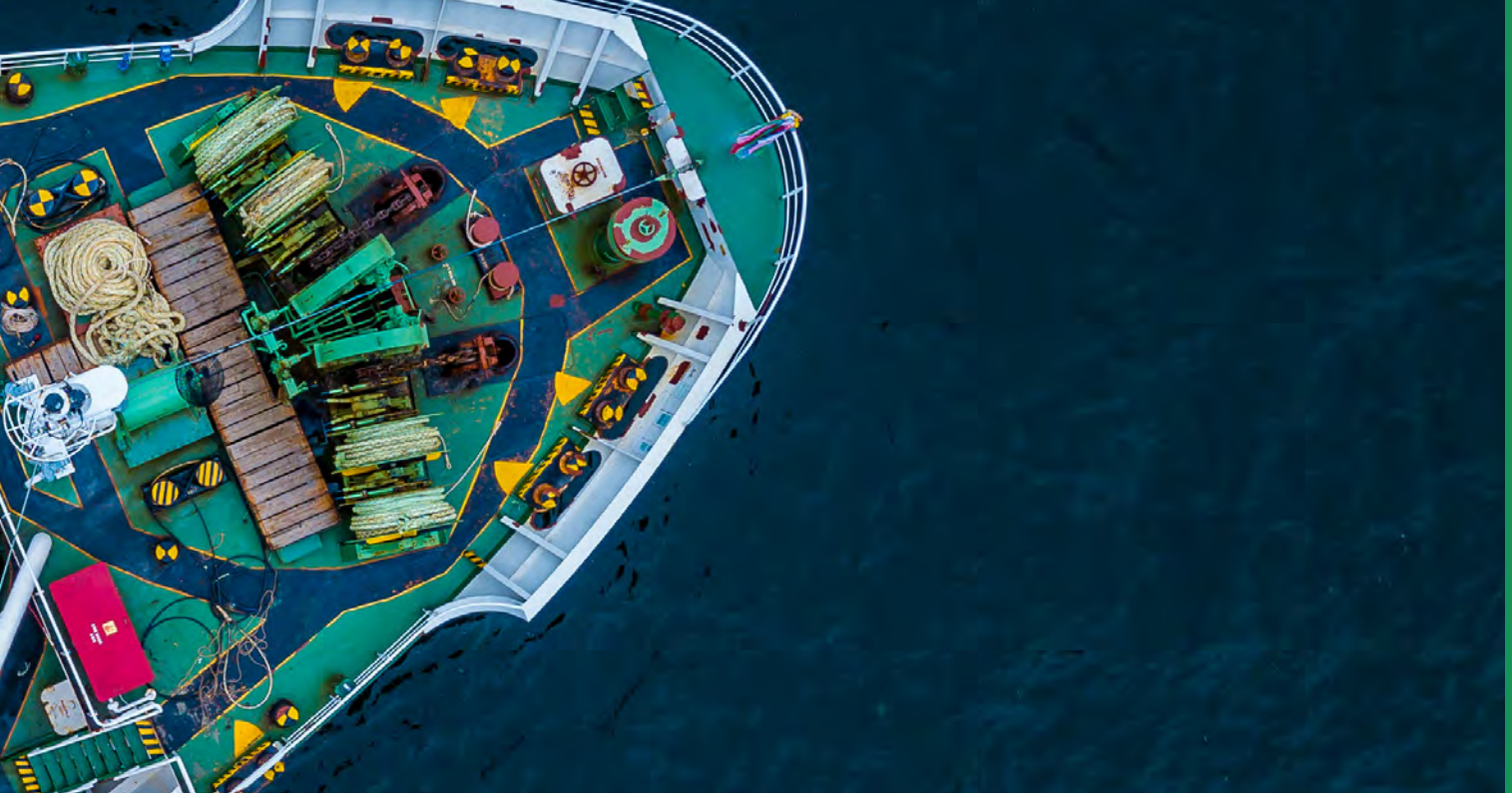
Damages

The Commercial Court found that there was a market for off-spec oil in 2018. Septo submitted that TSP fuel could be sold at USD 350 per mt which reflected the price that Septo hoped to achieve after a successful re-blending operation. The Commercial Court found that on the basis of USD 350 per mt. the loss suffered by Septo was USD 3.06m. Septo's damages claim for USD 7.79m was based on a notional cost of cure as opposed to the actual cost of cure in respect of the re-blended fuel. Septo was therefore awarded the sum of USD 3.06m.

Court of Appeal Decision

The Court of Appeal unanimously overturned to decision of the Commercial Court

In considering the authorities the Court of Appeal considered that there is a distinction between a printed term which qualifies or supplements a specially agreed term and one which transforms or negates it. In order to decide on which side of this line any particular term falls,



the question is whether the two clauses can be read together fairly and sensibly so as to give effect to both. This question must be approached practically, having regard to business common sense, and is not a literal or mechanical exercise. It will be relevant to consider whether the printed term effectively deprives the special term of any effect. If so, the two clauses are likely to be inconsistent. It will also be relevant to consider whether the specially agreed term is part of the main purpose of the contract or, which is much the same thing, whether it forms a central feature of the contractual scheme. If so, a printed term which detracts from that scheme is likely to be inconsistent with it. Ultimately, the object is to ascertain the intention of the parties as it appears from the language in its commercial setting.

The Court of Appeal considered that the Commercial Court was right to conclude that the effect of the Recap term, considered on its own, is that the quality certificate is intended to be binding on both parties for all purposes. That is the clear meaning of the term.

Accordingly, the starting point for consideration of the issue of inconsistency is that the Recap term provides that the quality certificate issued by the mutually acceptable independent inspector is binding on the parties, so that (assuming always that the certificate shows the product to be on-spec) the buyer cannot thereafter bring a claim on the ground that the quality of the product is not in accordance with the contract.

The next step is to consider the effect of the printed term. Clause 1.2.1 of the BP Terms provides that the quality certificate is to be *'conclusive and binding on both parties for invoicing purposes'* and that the buyer is obliged to make payment in full, but that this is *'without prejudice to the rights of either party to make any claim pursuant to Section 26'*, that is to say a claim that the product is not in accordance with the specification. Plainly this is different from the Recap term.

Clause 1.2.1 of the BP Terms was in conflict with the Recap term. The two provisions cannot fairly and sensibly be read together. The printed term does not merely qualify or supplement the Recap term, but rather deprives it of all practical effect:

— First, the Recap term provides for the quality certificate to be binding for all purposes, so as to preclude a claim for damages for breach of quality, while the printed term provides that the binding nature of the certificate is for a very limited purpose. This does for practical purposes deprive the Recap term of all effect.

— Second, a regime in which a certificate of quality is binding is fundamentally different from one in which it is not.

— Third, the provision in the Recap for the quality certificate to be binding is a central feature of the contractual scheme. It defines the seller's obligation with regard to the quality of the product, that obligation being to provide a product which is certified by the independent inspector as being in conformity with the contractual specification. In the case of a liquid cargo whose composition can only be determined by sampling and analysis, and where no two sets of samples are likely to be exactly the same, this provides an important measure of certainty. It is unlikely that the parties would wish substantially to detract from this by means of printed terms.

— Finally, it is necessary to stand back and consider the intention of the parties as practical business people operating in the real world. While it is perfectly reasonable for parties to choose a contractual scheme in which the quality certificate is not binding but is merely evidence, it is appropriate to ask whether that is a commercially reasonable interpretation of what they have done in this case. If the parties' intention was to provide that the quality certificate would not be binding in any real sense, they went about it in a very strange way, first by saying in the Recap that it would be binding and then by providing something different in standard conditions which could be argued to qualify and not to nullify what was said in the Recap.

For much the same reasons, the Court of Appeal would decide that Clause 1.3 of the BP Terms has no application in this case either. Like Clause 1.2, it provides for a fundamentally different regime from that set out in the Recap term and deprives the Recap of practical effect.

Comment

Two issues of importance arise from this decision of the Commercial Court and the Court of Appeal for the drafting of oil and gas contracts:

First, notwithstanding the decision of the Court of Appeal, caution should be exercised in relying on inconsistency (or priority) clauses when drafting or interpreting contracts. As explained by Sir Kim Lewison *'The court is reluctant to hold that parts of a contract are inconsistent with each other, and will give effect to any reasonable construction which harmonises such clauses'* (see Lewison, The Interpretation of Contracts (2015) 6th Ed., paragraph 9.13). As such, it is good drafting practice to seek to ensure that any potential divergence of approach between specific and general terms of a contract are dealt with at the drafting stage by removing any divergence – as English law will not necessarily disapply one element through relying on an inconsistency (or priority) clause.

Second, Clause 1.2.1 of the BP Terms operate on a 'pay now, argue later' basis. Therefore, certificates of quantity and quality do not give the parties finality. They operate merely to create certainty for the purposes of invoicing. Materially the same provision appears in the current 2015 BP General Terms and Conditions at Clause 2.2.1. However, the window for a claim is not open ended. Clause 59 requires that: *'Any complaint of deficiency of quantity or of variation of quality shall be admissible only if notified in writing to the Seller within 45 days of the completion of discharge date and accompanied by evidence fully supporting the complaint'*. As such the current 2015 BP General Terms and Conditions continue to appreciate the importance of swift notification of quality disputes – such as to prevent the type of belated claim made in *Trafigura Beheer BV v Renbrandt Ltd* [2017] EWHC 3100 (Comm). (see CMS Annual Review of developments in English oil and gas law (2018 Edition) page 25).

Third, careful consideration should be given to potential inconsistencies between special and standard terms. Although the use of standard terms may save significant bespoke drafting – potential inconsistencies with special terms agreed between the parties may result in disputes. As such, where standard terms are used it may be necessary to amend certain clauses for consistency.

Judges:
Commercial Court: Teare J.
Court of Appeal: Moylan LJ, Males LJ, Phillips LJ.

No damages awarded for breach of capacity obligation in take or pay arrangement

In *British Gas Trading Limited v Shell UK Limited & Anor* [2020] EWCA Civ 2349, the Court of Appeal considered the 'ramp down' provisions of two 'take or pay' long term gas sales agreements. Although the sellers were in breach of contract for not providing the relevant capacity notices to the buyer with the effect of ramping down 'take or pay' quantities (which would have allowed the buyer to escape expensively priced long-term gas), the buyer was still under an obligation to buy the gas and the breach did not result in a compensable loss. The decision serves as a reminder as to the criticality of careful drafting of provisions linked to 'take or pay' quantities.

Facts

The Principal Agreements

Two long term agreements for the sale of gas from reservoirs in the North Sea on materially identical terms were entered into between Shell UK Limited and Esso Exploration & Production UK Limited (the '**Sellers**'), and British Gas Trading Limited ('**British Gas**'), as buyer, in December 1988 (the '**Principal Agreements**').

The Principal Agreements were 'take or pay' agreements, providing for a minimum amount of gas that British Gas must either take delivery of, or pay for, every year. The quantity of gas which British Gas was required to take depended on the Total Reservoirs Daily Quantity ('**TRDQ**'). The TRDQ changed over the life of the contract with three distinct periods (starting with the 'Run-In Period', it increased during the 'Build-Up Period' and was followed by the 'Plateau Period'). After expiry of the 'Plateau Period', the TRDQ was constant until reduced pursuant to variation notices which the Sellers had a right to serve if they considered that they would be unable to maintain the TRDQ during a contract year. The TRDQ could not be increased.

Pursuant to Clause 6.4(1) the Sellers were required to maintain the capacity to deliver gas from the reservoirs at the rate of 130% of the TRDQ. The wording of Clause 6.4(1) stated:

'Subject to clause 6.8 with effect from the Start Date the Seller shall provide and maintain a capacity (herein referred to as the 'Delivery Capacity') to deliver Natural Gas from the Reservoirs on each Day at a rate of not less than the DCQ applicable for such Day multiplied by one hundred and thirty (130) percent and BG shall have the right on any and every Day (subject as herein provided) to require delivery of Natural Gas at rates up to the appropriate Delivery Capacity determined hereunder notwithstanding that the aggregate of such daily requirements made in respect of any Contract Year exceed the ACQ…'

The 'DCQ' was each Sellers's proportion of the TRDQ. Each Seller's Proportion was 50% and each Seller's DCQ was therefore 50% of the TRDQ.

Shell Bacton Sub-Terminal Allocation Commingling and Attribution Agreement

The Sellers, British Gas, and producers from other reservoirs were parties to a Shell Bacton Sub-Terminal Allocation Commingling and Attribution Agreement dated 30 September 1997 (the '**STACA**').

The STACA required:

1. gas produced from a number of different reservoirs to be commingled and processed at a Shell sub-terminal, and for processed gas to then be re-delivered to producers on a pro rata basis for delivery to British Gas and producers from other reservoirs; and

2. gas to be lent and borrowed between 'User Groups' such that the Sellers were required to lend gas produced from the Sole Pit Reservoirs to producers from other reservoirs to ensure that if there was shortfall in one reservoir, it could be compensated by another. The gas lent had to be repaid to the Sellers as soon as reasonably practicable.

In this case, the Sellers had accumulated a large amount of gas which had been lent to other User Groups. Accordingly, there was a balance of 72,811 terajoules of gas owed by the User Groups to the Sellers under the STACA. The Sellers were able to supply British Gas using these reserves of 'repayment' gas.

The Sellers served several variation notices reducing the TRDQ between 2000 and 2009 as the production volumes of the Reservoirs declined.

The dispute

British Gas did not complain of any failure by the Sellers to deliver the amounts of gas properly nominated for delivery under the Principal Agreements. It argued that the Sellers were in breach of the obligation under Clause 6.4(1) of the Principal Agreements to provide and maintain a capacity to deliver gas from the Reservoirs at a specified rate. British Gas contended that, in order to comply with that obligation in circumstances where production volumes were in decline, the Sellers ought to have served additional variation notices to reduce the TRDQ. In turn, this would have resulted in a reduction of the volume that British Gas was obliged to 'take or pay'. If such reductions had occurred, British Gas would have bought other gas in the market at a cheaper price.

Commercial Court Decision

At first instance the Commercial Court dismissed British Gas's claim that Clause 6.4(1) of the Principal Agreements required the Sellers to deliver the agreed capacity from the Reservoirs only; and that a term should be implied that the Sellers' right to issue variation notices to reduce the TRDQ should be exercised honestly and in good faith. It held that to determine whether the Sellers maintained the necessary capacity, it was permissible to take account of the 'repayment' gas from other reservoirs owed to the Sellers by other User Groups. Accordingly, the Sellers were found not to be in breach of their obligations.

The issue of damages for breach of the capacity obligation under Clause 6.4(1) did not arise at first instance due to the conclusion on liability. Yet, the judge found that if it had arisen, damages would be assessed on the basis that the variation notices would have reduced the amount of gas that British Gas was required to take.

British Gas appealed the decision on the construction of the obligation under Clause 6.4(1) of the Principal Agreements, and the Sellers cross-appealed on the issue of assessment of damages.

Court of Appeal Decision

The Court of Appeal favoured British Gas' submissions concerning the construction of Clause 6.4(1) and allowed the appeal. However, it decided that the breach did not result in any loss or damage. It found that:

1. The obligation owed under Clause 6.4(1) was a capacity obligation to supply gas from the Reservoirs, not a delivery obligation.

2. The fact that the TRDQ changes over the life of the contract suggested that the TRDQ and thus the Delivery Capacity were expected to be based upon the physical production capacity of the Reservoirs.

3. Clause 4.1 of the Principal Agreements says nothing about the availability to the Sellers of gas from other reservoirs. That was a strong indication that gas from other sources was not intended to be taken into account.

As a result, absent sufficient variation notices, the Sellers were in breach of their Clause 6.4(1) obligation to ensure the Delivery Capacity was not less than 130% of the DCQ.

Damages

However, the Court of Appeal allowed the Sellers' cross-appeal on the assessment of damages. It disagreed with the Commercial Court that the Sellers were under an obligation to track the decline of the reservoirs by the service of variation notices.

The Court of Appeal concluded that damages for breach of contract must be assessed on the basis that the Sellers had performed their obligation. That is not the same as saying that damages should be assessed as if the Sellers had taken steps to avoid being in breach of contract in the first place. The breach here was the failure to maintain Delivery Capacity of 130% of the TRDQ. It was not the failure to serve a variation notice. The Sellers were not under an obligation to serve a variation notice each and every time Delivery Capacity may not be 130% of the TRDQ.

Damages could not be assessed as if the Sellers were under an obligation to serve a variation notice: they were not.

The relevant counterfactual for the purpose of assessing damages was that the Sellers would have maintained a Delivery Capacity of 130% of the TRDQ per day. On this basis, British Gas had suffered no loss. If the Sellers had complied with their obligations they would have delivered the same quantity of gas at the same price.

Comment

The economic facts underlying the case are that the Principal Agreements clearly created a price above market, such that British Gas was keen to reduce its exposure to 'take or pay' quantities. The Principal Agreements also clearly envisaged that the Sellers would have started to reduce these quantities. However, on the Court of Appeal's construction, the agreements failed to oblige the Sellers to reduce quantities. The Principal Agreements merely gave the Sellers the opportunity to do so to avoid a breach of contract of their obligations as to maintaining sufficient capacity.

This case highlights the need for buyers to carefully consider the drafting of provisions linked to 'take or pay' volumes, such as any 'ramp down' phase of the field in a 'take or pay' agreement. Unless a seller is obliged to issue a notice, it may not do so if it can source gas from elsewhere to satisfy volumes without contractual breach.

The Principal Agreements were typical life of field contracts. The way that the Principal Agreements were drafted meant that the Sellers were under no obligation to serve a variation notice to reduce the TRDQ if they were unable to comply with their obligations to supply 130% of the TRDQ. Accordingly, failure to serve a variation notice did not amount to a breach of the Principal Agreements and damages could not be assessed as if the Sellers were required to serve such a variation notice. British Gas would only have suffered damage if there had been an obligation to issue a variation notice.

Lady Justice Andrews and Lord Justice Peter Jackson, both concurring with Lord Justice Males, made an observation that this contract contained a careful internal tension linking performance on both sides with production capacity. The Sellers' '*capacity obligation*' required them to maintain the physical capacity to meet the prevailing contract quantities. The breach of Clause 4.1 of the Principal Agreements can occur with impunity, provided that the Sellers deliver enough equivalent gas to meet British Gas' nominations. British Gas is locked into taking and paying for gas that it does not want on grounds of price. This outcome effectively short-circuited the protection contained in the default provisions of the Principal Agreements, which provided a detailed regime for British Gas to be entitled to cheaper gas later on, should the Sellers fail to deliver the nominated amount of gas on time.

Judges:
Commercial Court: Mr Persey QC.
Court of Appeal: Jackson LJ, Males LJ, Andrews LJ.

Limiting liability in supply contracts: further guidance on the UCTA requirement of reasonableness

In *B A Kitchen Components Ltd v Jowat (UK) Ltd* [2021] NIQB 3 the Northern Ireland's High Court rejected an attempt to rely on a standard form limitation clause which sought to limit a supplier's liability for defects to the price of goods supplied. The High Court found that the clause did not meet the requirement of reasonableness under the Unfair Contract Terms Act 1977 and awarded the purchaser substantial damages for the cost of rectifying the works into which the goods had been incorporated. The decision is notable as the first UCTA case on supply contracts since the Court of Appeal's decision in the *Goodlife* case in 2018 where a trend toward upholding limitation clauses was suggested.

Facts

B A Kitchen Components Ltd ('**Kitchen Components**') is a manufacturer of kitchen doors. In 2003 it contracted Jowat (UK) Ltd ('**Jowat**') to supply adhesive for the purpose of bonding together MDF and PVC as part of the manufacturing process. However, the adhesive was inherently defective and not compatible with the type of MDF used by Kitchen Components, with the result that there was delamination of the affected doors.

Kitchen Components brought a claim against Jowat for losses suffered as a result, principally the costs of replacing the affected doors. Jowat defended the claim by seeking to rely on an exclusion clause contained within its standard terms and conditions. The relevant part of the clause, which the High Court found to be validly incorporated into the contract, read:

'Where any claim in respect of any of the goods which is based on any defect in the quality or condition of the goods or the failure to meet specification is notified to the seller […] the sellers will be entitled to replace the goods (or the part in question) free of charge or at the seller's sole discretion refund to the buyer the price of the goods (or a proportionate part of the price) but the seller shall have no further liability to the buyer' (Clause 8.4).

Decision

The High Court considered, among other things, whether Clause 8.4 failed to satisfy the reasonableness requirement in the Unfair Contract Terms Act 1977 ('**UCTA**'). This applies to exclusion or limitation clauses in contracts based on a party's standard terms and conditions and to any exclusion or limitation clause relating to liability for negligence.

In reaching its decision, the High Court considered the competing conclusions as to the question of reasonableness reached in two previous cases involving supply contracts: *Balmoral Group Ltd v Borealis [UK] Ltd* [2006] EWHC 1900 (Comm) and *Goodlife Foods Ltd v Hall Fire Protection Ltd* [2018] EWCA Civ 1371.

Goodlife concerned the supply and installation of a fire suppression system and the clause in question excluded all liability save for the replacement of defective parts, which the English Court of Appeal upheld as reasonable. This was because (i) the parties were of equal bargaining power; (ii) the only loss in contemplation was fire, which was a risk that Goodlife was reasonably expected to insure against; and (iii) the clause specifically alerted Goodlife to the availability of insurance to cover losses excluded by the clause, and noted that the supplier could provide insurance to cover the same.

By contrast in *Balmoral*, where liability in relation to the supply of polyethylene polymer was limited to the exchange of defective products with non-defective products or the price paid for the defective products, this was found to be incompatible with UCTA. The key reasons for this were (i) the supplier knew the product was for use in the manufacture of oil tanks and that the purchaser was relying on it to supply a polymer suitable for such a use; (ii) it was foreseeable that a latent defect in the polymer would cause large losses to the purchaser because it would have to replace the tanks manufactured using the polymer; and (iii) the supplier had product liability insurance which would respond to the purchaser's claim.

The High Court found the clause in this case did not meet the requirement of reasonableness and awarded Kitchen Components damages for the costs of replacing the affected doors. The High Court emphasised that there was an inherent defect in the adhesive and that Jowat was aware that Kitchen Components intended to use the adhesive for bonding MDF and PVC to manufacture kitchen doors. It was therefore apparent to Jowat that if the adhesive was ineffective, the doors would fail and it was foreseeable that Kitchen Components would be required to replace them. The position was therefore more aligned with the facts of *Balmoral* than with *Goodlife*.

The High Court also considered that, to the extent such loss might be disproportionate to the cost of the adhesive, Jowat was well placed to obtain and did in fact obtain the requisite insurance, in contrast to the position of the supplier in *Goodlife*. On this basis, it was deemed more appropriate that the risk of loss from the defect should fall on Jowat as supplier.

Comment

This case provides support for the continued application of the reasoning in the *Balmoral* case to standard form limitations of liability in supply contracts. The Court of Appeal's decision in *Goodlife* had noted a trend in UCTA cases toward upholding terms freely agreed where the parties were of equal bargaining power. It was unclear to what extent this trend might be relied upon to distinguish *Balmoral* in future cases – *Balmoral* having been decided in 2006.

Application of the *Balmoral* reasoning suggests that supply contracts which limit liability to the price of goods supplied will rarely satisfy the requirement for reasonableness under UCTA unless they are of a sufficiently generic nature that the supplier is not to be taken to have notice of the use to which the goods are to be put and any broader works or products into which they will be incorporated. If the supplier does have such knowledge, the availability of product liability insurance is likely to tip the balance against the reasonableness of such a limitation, unless circumstances similar to those in *Goodlife* apply, where the consequences of failure is something which the purchaser would be expected to insure against (e.g. fire).

Suppliers would be well advised to employ other means of seeking to reduce levels of liability, such as limiting liability to multiples of the contract price, or including tiered provisions to provide alternative levels of protection in the event any primary exclusions are found to be unreasonable.

Judge: Sir Ronald Weatherup.

Chapter 7

Dispute Resolution

The past twelve months have also seen a number of cases relevant to the particular dispute resolution clauses, and dispute resolution processes, used in the oil and gas industry:

1. In *Enka Insaat Ve Sanayi AS v. OOO Insurance Company Chubb* [2020] UKSC 38 the Supreme Court confirmed the English law approach to identifying the governing law of arbitration agreements where a separate governing law is not identified in the arbitration agreement (as distinct from the contract).

2. In *Halliburton v Chubb* [2020] UKSC 48 the Supreme Court gave critical guidance on arbitrator conflicts, from multiple appointments, arising from the Macondo well incident.

3. In *Secretariat Consulting PTE Ltd & Ors v A Company* [2021] EWCA Civ 6 the Court of Appeal gave guidance on conflicts of interest for expert witness on multiple appointments.

4. In *Flowgroup plc v Co-operative Energy Ltd* [2021] EWHC 344 (Comm) the Commercial Court interpreted the scope of a 'manifest error' provision in an expert determination clause.

5. In *AT, DV, SD, HG v Oil & Gas Authority* [2021] EWHC 1470 (Comm) the Commercial Court decided whether a dispute in respect of a proposed course of action by the Oil and Gas Authority fell within the scope of the arbitration agreement contained in the UKCS Licence Model Clauses.

6. In *Shapoorji Pallonji & Company Private Ltd v Yumn Ltd* [2021] EWHC 862 (Comm), the Commercial Court provided important guidance on the relationship between Emergency Arbitration proceedings and interim relief from the English courts.

Identifying the governing law of arbitration agreements

In *Enka Insaat Ve Sanayi AS v OOO Insurance Company Chubb* [2020] UKSC 38 the UK Supreme Court handed down judgment concerning the governing law of arbitration agreements and the English courts' ability to grant anti-suit injunctions in support of arbitration.

Facts

On 1 February 2016 a power plant in Russia was severely damaged by a fire. The owner of the power plant was a company now named PJSC Unipro ('**Unipro**'). An insurer, OOO Insurance Company Chubb ('**Chubb Russia**'), had insured the power plant against damage. Chubb Russia is a part of the Chubb Group.

The company responsible for the design and construction of the power plant under a contract made with Unipro in May 2011 was a Russian company called CJSC Energoproekt ('**Energoproekt**'). Enka Insaat Ve Sanayi AS ('**Enka**') was engaged by Energoproekt as one of many subcontractors involved in the construction project. Enka is a global engineering and construction company incorporated and based in Turkey with a substantial presence and history of operations in Russia, amongst other countries.

The contract between Energoproekt and Enka dated 27 June 2012 (the '**Construction Contract**') was executed in parallel Russian and English versions (though it provides that the Russian language version has precedence) and contained an arbitration clause. The arbitration clause referred disputes to '*be finally settled under the Rules of Arbitration of the International Chamber of Commerce*' with the place of arbitration being London, England. However, the arbitration agreement, and the Construction Contract, did not contain an express term dealing with governing law.

On 21 May 2014, Energoproekt transferred its rights and obligations under the Construction Contract to Unipro pursuant to an assignment agreement made between Energoproekt, Unipro and Enka. By Clause 7.5 of that agreement, the parties agreed that disputes between Unipro and Enka were to be finally and exclusively resolved by arbitration in accordance with the provisions of the Construction Contract.

After the fire in February 2016 Chubb Russia paid RUB 26.1b (approximately USD 400m) to Unipro under its property insurance policy and thereby became subrogated to any rights of Unipro to claim compensation from third parties for the damage caused by the fire.

On 25 May 2019 Chubb Russia filed a claim in the Moscow Arbitrazh (i.e. Commercial) Court against Enka and ten other defendants whom it claimed were jointly liable for the damage caused by the fire.

The proceedings were based on a construction contract under which Enka was engaged. Subsequent to proceedings being issued in Russia by Chubb Russia, Enka filed a motion in Russian proceedings to have Chubb Russia's claim against it dismissed. Enka argued that the dispute between the two parties fell within the scope of the arbitration agreement contained in the Construction Contract and as such, ought to be resolved by arbitration; conducted in London, not the Russian courts. The Russian court decided (a) not to grant Enka's motion to refer the claim against it to arbitration and (b) to dismiss Chubb Russia's claims against all the defendants on the merits.

Meanwhile, on 16 September 2019, Enka brought an arbitration claim in the Commercial Court in London, seeking an anti-suit injunction to restrain Chubb Russia from further proceedings against Enka in Russia on the basis that this was in breach of the arbitration agreement. On 15 October 2016, the English Commercial Court declined to grant an interim anti-suit injunction as it did not consider the English courts to be an appropriate forum to decide the dispute.

Court of Appeal Decision

The role of the seat and forum conveniens: anti-suit injunction

The Court of Appeal found that the approach at first instance to the role of the seat was *'wrong in principle'*. Rather, the English Court as the court of the seat of the arbitration was *'necessarily'* the appropriate court to grant an anti-suit injunction and the question of *forum conveniens* did not in fact arise.

The Court of Appeal drew upon previous authorities in observing that the *'choice of seat is by its very nature a submission to the curial [or procedural] jurisdiction'* of that seat and the primary function of court of the seat is to determine whether an anti-suit injunction should be granted. It further held that questions of *forum conveniens* do not arise when the court is exercising that curial jurisdiction, which would undermine certainty and party autonomy.

The governing law of the arbitration agreement

In determining the 'proper law' of the arbitration agreement, the Court of Appeal noted that it is well established that such law may not necessarily be the same as the main contract law. Although the English courts have generally preferred to adopt the law governing of the main contract as the law governing the arbitration agreement (e.g. in *Channel Tunnel Group Ltd v Balfour Beatty Ltd* [1993] AC 334 and *Kabab Ji S.A.L v Kout Food Group* [2020] EWCA Civ 6), the courts have also held that in the absence of an express choice of law, the governing law is more likely to be the law of the seat of the arbitration rather than the law of the main contract (e.g. *C v D* [2007] EWCA Civ 1282).

Seeking to *'impose some order and clarity on this area'*, the Court of Appeal set out the following test to determine the governing law of the arbitration agreement:

1. Application of the English common law conflict of laws rules, namely: (i) is there an express choice of law? (ii) if not, is there an implied choice of law? (iii) if not, with what system of law does the arbitration agreement have its closest and most real connection?

2. Where there is an express choice of law in the main contract, it may amount to an express choice of the law for the arbitration agreement. Whether it does so will be a matter of construction of the whole contract, including the arbitration agreement, applying the principles of construction of the main contract law.

3. In the absence of express choice, there is a '*strong presumption*' that the parties have impliedly chosen the law of the seat as the governing law of the arbitration agreement. However, this is a rebuttable presumption and another system of law could govern the arbitration agreement where there are powerful countervailing factors in the relationship between the parties or the circumstances of the case.

The Court of Appeal treated the choice of seat in the arbitration agreement as an implied choice of law for the arbitration agreement in accordance with 1(ii) above.

Supreme Court Decision

Following a hearing in July 2020, the Supreme Court handed down judgment on 9 October 2020. The Court dismissed the appeal by a 3:2 majority, with Lord Hamblen and Lord Leggatt giving the leading judgment (with whom Lord Kerr agreed) and Lord Burrows and Lord Sales each giving dissenting judgments. Although the majority reached the same outcome as the Court of Appeal in holding that the governing law of the arbitration agreement in this instance was English law, its reasons for doing so were partly different from the Court of Appeal. It is this difference that is significant.

Three systems of national law and the role of 'curial law'

The Supreme Court majority opened its judgment with some important remarks on the distinctions to be drawn between the *'three systems of national law […] engaged when a dispute occurs'*. These are:

(i) the law governing the substance of the dispute, which is generally the law applicable to the main contract;

(ii) the law governing the agreement to arbitrate; and

(iii) the law governing the arbitration process (the 'curial law', which is the law of the seat of the arbitration).

The Supreme Court emphasised that the laws governing the substance of the dispute and the curial law may be different from each other, and different from the law governing the validity and scope of the arbitration agreement.

The Supreme Court decided that the extent to which the choice of curial law (i.e. the choice of seat) carries any implication that the parties intended the same system of law to govern the arbitration agreement also depends on the content on the curial law. In that regard, the Supreme Court found that under the English Arbitration Act 1996 there is no basis for a general inference that parties who choose London or another English seat of arbitration always intend their arbitration agreement to be governed by English law. Moreover, the primary reason for selecting London as a place of arbitration is, for the Supreme Court, the attractiveness of London as a forum in which to arbitrate international disputes, where international arbitrators qualified in England and Wales are *'perfectly familiar with applying systems of law other than their own'*. Indeed, in the English courts as well *'questions of foreign law are dealt with […] on a daily basis'*.

What is the correct approach to determining the proper law of an arbitration agreement?

In summary, the principles established by the majority in the Supreme Court are:

1. The starting point is the English common law rules for resolving conflicts of laws rather than the provisions of the Rome I Regulation because article 1(2)(e) of Rome I excludes from its scope *'arbitration agreements and agreements on the choice of court'*.

2. The next question is what law is chosen by the parties to govern the arbitration agreement. In the absence of such a choice, the governing law will be law with which the arbitration agreement is most closely connected.

3. In order to determine whether the parties have made a choice, the arbitration agreement and the contract containing it are to be construed, as a whole, applying the rules of contractual interpretation of English law (being the forum of the dispute).

4. If there is no separate choice of law for the arbitration agreement, but there is a choice of governing law for the main contract, the main contract governing law will generally apply to the arbitration agreement. The Supreme Court stated it would *'put the principle of separability of the arbitration agreement too high'* to say that a choice of law to govern the main contract has '*little to say*' about the choice of law of the arbitration agreement. The Supreme Court majority's approach also accords with commercial common sense, recognising that commercial parties are unlikely to be familiar with the separability principle and that for them, in the words of the majority, *'a contract is a contract […] they would therefore reasonably expect a choice of law to apply to the whole of that contract'*.

5. The fact that the seat of the arbitration is different from the choice of governing law of the main contract is not on its own enough to negate an inference that the governing law of the main contract applies to the arbitration agreement as well. The Supreme Court rejected here the reasoning of the Court of Appeal, noting that there is no *'strong presumption'* that the parties have, by implication, chosen the law of the seat of the arbitration to govern their arbitration agreement.

6. However, factors that can indicate a different governing law for the arbitration agreement are:

   (a) a provision of the law of the seat which indicates that, where an arbitration is subject to that law, the arbitration agreement will also be treated as governed by that country's law (e.g. Section 6 of the Arbitration (Scotland) Act 2010); or

   (b) the existence of a serious risk that, if governed by the same law as the main contract, the arbitration agreement would be ineffective (this is in keeping with the 'validation principle' of English law that *'the contract should be interpreted so that it is valid rather than ineffective'*). The Supreme Court majority recognised that this will require having regard to the words used in the contract, the surrounding circumstances and the extent of the risk that the arbitration agreement would be undermined if its validity and scope were governed by the relevant system of law. The Supreme Court

majority reiterated the formulation of Lord Moore-Bick in the *Sulamérica Cia Nacional de Seguros SA v Enesa Engenharia SA* [2012] EWCA Civ 638, paragraph 31, that commercial parties are generally unlikely to have intended a choice of governing law for the contract to apply to an arbitration agreement if there is *'at least a serious risk'* that a choice of that law would *'significantly undermine'* that agreement.

7. If there is no express choice of law to govern the main contract, it does not automatically follow that the contract (or the arbitration agreement) is intended to be governed by the law of the seat.

8. If, following the above, there is no express or implied choice of law that can be determined, then one is required to determine the law with which the arbitration agreement is most closely connected. It is only then that it may be said the arbitration agreement is most closely connected with the law of the seat chosen by the parties. The majority held that despite the reasonable assumption, as a starting point, that the parties have intended for all terms of their contract to be governed by the same system of law, there is authority (including *Sulamérica*) for a *'general rule'* that the arbitration agreement is most closely connected with the law of the seat of the *arbitration*, even if that law differs from the law applicable to the parties' substantive obligations. The majority noted that the seat is where the arbitration is to be performed (legally speaking, if not physically), whereas the place of performance of the substantive obligations of the contract may not have a *'significant connection'* for the purpose of determining the law of the arbitration agreement.

9. Dispute resolution clauses that include provisions for good faith negotiation, mediation or any other procedure before a dispute can be referred to arbitration will not generally provide a reason to displace the law of the seat of arbitration as the law applicable to the arbitration agreement when the above applies.

In his dissenting judgment Lord Burrows was of the view that *'absent an express choice of law in the arbitration agreement, there is a presumption (or general rule) that the proper law of the main contract is also the proper law of the arbitration agreement; and there is no such presumption (or general rule) that the law of the seat is the proper law of the arbitration agreement'*.

In the present case, Lord Burrows was also of the view that if there is no express or implied choice of law that applies then the country with which the contract is most closely connected ought to be the same as that of the laws governing the main contract as opposed to the country of the seat.

Application to the present case

For the majority of the Supreme Court, this case fell to be decided by reference to point 8 above, i.e. there was no express or implied choice of law for either the arbitration agreement or the main contract. Accordingly, the majority considered with which system of law the arbitration agreement was most closely connected and decided it was the law of the seat (i.e. English law).

For the dissenters, the position was more straightforward. The dissenting opinion was that there was a choice of law in relation to the main contract, being Russian law, and this ought to have carried across to the arbitration agreement.

Anti-suit injunction: the power of a London seat

The majority decided that in granting an anti-suit injunction, the English courts are seeking to uphold and enforce the parties' contractual bargain as set out in the arbitration agreement. Therefore, in principle it should make no difference whether that agreement is governed by English law or by a foreign law. In both cases the enquiry is whether there has been a breach of the arbitration agreement and whether it is just and convenient to restrain that breach by the grant of an anti-suit injunction. The majority agreed with the Court of Appeal that *forum conveniens* was not relevant; the parties had agreed to arbitration in London and therefore to submit to the supervisory jurisdiction of the English courts.

The granting of an anti-suit injunction is always a matter of discretion, and although in some cases it may be sensible to await a decision of a foreign court, this deference and the principle of comity is outweighed by the importance of upholding the parties' bargain (to arbitrate).

Comment

Despite the complexities of this area of the law, the key takeaway from the judgment is that 'choice' will always prevail. Wherever possible, in order to ensure certainty in the event of a dispute, the parties should consider and agree in their contracts upon all three systems of law that will be relevant to a dispute: (i) the law applicable to the main contract (the substantive law); (ii) the law governing the agreement to arbitrate; and (iii) the seat of the arbitration. This will be particularly important where the country of the governing law of the contract is different from the country of the seat.

Where parties have selected a law applicable to their main contract, this is likely to apply to their arbitration agreement as well, even if the law of the seat is different. This is subject to the factors set out in point 6 above, including the application of the 'validation principle', which is likely to assist in preventing parties from circumventing their arbitration agreements.

Commercial parties may nevertheless find themselves in difficulty when they fail to turn their minds to two out of three of the systems of law when drafting their contract. If the only reference to a system of law in the contract is to the seat of the arbitration, the search for their intentions will end, replaced by the objective application of a rule of law looking for the system of law most closely connected with the arbitration agreement. Although not rooted in the parties' intentions, this general rule is nevertheless beneficial for parties insofar as it will provide certainty for parties faced with disputes arising out of contracts that are silent as to the applicable law.

The difference in analysis between the majority and the dissenters on the law governing the main contract will, no doubt, be instructive in future disputes not just about the governing law of the arbitration agreement, but also the governing law of other contacts.

Judges:
Court of Appeal: Flaux LJ, Males LJ, Popplewell LJ.
Supreme Court: Lord Kerr JSC, Lord Sales JSC, Lord Hamblen JSC, Lord Leggatt JSC, Lord Burrows JSC.

The CMS' Oil and Gas Disputes Survey: Managing Disputes Risk – The In-House Perspective

The CMS Oil and Gas Disputes Survey examined the key drivers of disputes and dispute management in the oil and gas industry, and how sector participants are moving towards new approaches to minimise conflicts and disputes. Based on more than 50 responses from senior legal managers and senior in-house counsel in the oil and gas industry across Europe, the Middle East, Asia Pacific, Africa and Latin America, it provides interesting insights into how disputes arise and are managed around the globe.

The survey elucidates that the oil and gas giants, traditionally considered as being able to handle the downsides due to their profitable portfolios and partnerships, can no longer afford that luxury. Despite the survey suggesting an increase in dispute opportunities, it at the same time encourages the adoption of an increasing amount of prevention and mitigating measures against the same.

Access the guide here:

cms.law/en/gbr/publication/oil-and-gas-disputes-survey-managing-disputes-risk-the-in-house-perspective

As reported in the **Insider**, The Oil and Gas Dispute Survey found that:

'more could be done to prevent disputes, highlighting a number of areas where disputes could be mitigated - including managing change in projects; better understanding of local market factors prior to project execution; and better record keeping'

Arbitrator conflicts

In *Halliburton v Chubb* [2020] UKSC 48 the Supreme Court provided important clarification of the nature and scope of an arbitrator's duty to make disclosures of facts and circumstances that may give rise to doubts about the arbitrator's independence and impartiality, as well as how this duty interrelates with the duty of privacy and confidentiality, and the circumstances in which an arbitrator's failure to make a disclosure could give rise to an appearance of bias.

The Supreme Court also reiterated the importance of the duty of impartiality as a core principle of arbitration law, which applies equally to party-appointed and independently-appointed arbitrators, and the need to apply an 'objective observer' test in determining whether circumstances exist that create the appearance of bias. The Supreme Court grounded its reasoning in a detailed consideration of certain key differences between international arbitration and litigation, and how certain characteristics of arbitration would be taken into account by the 'objective observer' in assessing whether there was a real likelihood of an arbitrator being biased.

The Supreme Court further had regard to the diverging views, practices and legal systems within the arbitration community, noting that the fact that an arbitrator has accepted appointments in multiple arbitrations concerning the same or overlapping subject matter with only one common party is a matter which may have to be disclosed, depending upon the customs and practice in the relevant field.

Applying its detailed discussion of the relevant legal principles to this case, the Supreme Court held that the arbitrator in question had breached his duty of disclosure. However, for different reasons than those given in the lower courts, it further held that an objective observer, looking at the facts and circumstances that would have been known to him or her at the time of the hearing of the application to remove the arbitrator, would not have concluded that there was a real possibility of bias.

The Supreme Court's detailed judgment provide critical guidance for arbitrators, practitioners, institutions and arbitration users alike.

Facts

The case arises out of the 2010 Deepwater Horizon incident in the Gulf of Mexico. The oil rig concerned was owned by Transocean and leased to BP, who contracted with Halliburton Company ('**Halliburton**') for the provision of cementing and well-monitoring services. Chubb Bermuda Insurance Ltd ('**Chubb**') was the insurer for both Transocean and Halliburton.

Following the incident, Halliburton made an insurance claim, which Chubb refused to pay. Upon Halliburton commencing arbitration proceedings and the parties selecting their nominees, the High Court appointed a presiding arbitrator (Mr Kenneth Rokison QC, the '**Arbitrator**') in the absence of agreement between the parties. The Arbitrator had been Chubb's nominee for presiding arbitrator, but that suggestion had been rejected by Halliburton.

The Arbitrator was subsequently appointed as arbitrator in a further two arbitrations: one as Chubb's appointee in defending proceedings brought by Transocean, and another as substitute arbitrator in a further claim by Transocean against a different insurer. He did not disclose the appointments to Halliburton, as party to the arbitration in question. When Halliburton became aware of the appointments, it raised concerns regarding a failure by the Arbitrator to disclose a potential conflict of interest. Despite the Arbitrator's clarifications and explanations (in which he acknowledged that it would have been *'prudent'* to inform Halliburton of the appointments and apologised for not having done so), Halliburton called on the Arbitrator to resign. In circumstances where the Arbitrator had been appointed by the court and Chubb did not agree to the resignation, the Arbitrator confirmed he felt unable to resign. Halliburton made an application under section 24(1)(a) of the Arbitration Act 1996 (the '**Act**'), which gives powers to the court to remove an arbitrator if circumstances exist that give rise to justifiable doubts as to the arbitrator's impartiality.

Commercial Court Decision

At first instance, the Commercial Court found in favour of Chubb, concluding that there was nothing in the acceptance by the Arbitrator of the appointments in the two further arbitrations that resulted in the appearance of bias against Halliburton, even though the issues in dispute in both cases were identical or substantially overlapping. In addition, he decided that because the circumstances did not give rise to any justifiable concerns about the Arbitrator's impartiality, there was no duty on him to disclose to the claimant his appointment on an overlapping matter. In addition, even if a disclosure ought to have been made, the failure to do so did not give rise to a real possibility of apparent bias against Halliburton.

Court of Appeal Decision

The Court of Appeal dismissed Halliburton's appeal, although the Court disagreed with the finding of the Commercial Court in part in relation to the requirement to make a disclosure.

The Court of Appeal said that at *'the heart'* of Halliburton's appeal was the extent to which unfairness may arise if an arbitrator has been appointed in overlapping references with only one common party. The Court of Appeal considered the following factors raised by Halliburton:

1. The circumstances of the appointment;
2. the degree of overlap between the arbitrations;
3. the financial benefit from the further Chubb appointment;
4. the non-disclosure;
5. the Arbitrator's response to Halliburton's concerns; and
6. the views of a co-arbitrator, who expressed concerns about procedural fairness.

The Court of Appeal gave short shrift to points 1, 3, 5 and 6, focusing instead on the overlapping appointments and the non-disclosure.

As regards the overlap between the arbitrations, the Court of Appeal agreed with the Commercial Court that the *'mere fact'* of appointment in overlapping arbitrations did not, in and of itself, give rise to an appearance of bias. Using the language of Dyson LJ in *AMEC Capital Projects Ltd v Whitefriars City Estates Ltd* [2005] 1 WLR 723, *'something more is required'*, which must be *'something of substance'*.

An important feature of the Court of Appeal's judgment was its clarification regarding the link, or lack thereof, between the acceptance of overlapping appointments and the duty of disclosure: *'we do not consider that the fact that such appointments may be accepted is determinative of whether disclosure should be given before accepting such appointments'*. The Court of Appeal confirmed that the test to determine when a disclosure is required is an objective one, i.e. what would the fair-minded and informed observer conclude? The Court of Appeal concluded that the position under English law is that arbitrators must disclose *'facts or circumstances which would or might lead the fair-minded and informed observer, having considered the facts, to conclude that there was a real possibility that the arbitrator was biased'*.

Applying this test to the facts, the Court of Appeal decided that the relevant facts and circumstances were the Arbitrator's proposed appointment in related arbitrations, and in particular the arbitration involving Chubb alone as a common party. Whereas the Commercial Court did not consider that a disclosure was required, the Court of Appeal disagreed, finding that *'best practice in international commercial arbitration would have required disclosure of the other appointments'* and that, in the factual circumstances, a disclosure ought to have been made as a matter of law. Referring to the objective test of a fair-minded observer, the Court of Appeal noted that *'the natural expectation'* would have been disclosure of further Chubb appointments. In this regard that the Arbitrator himself agreed that it would have been *'prudent'* to make the disclosure, whilst recognising that it was clearly an innocent oversight on his part in failing to do so.

Supreme Court Decision

The Supreme Court unanimously dismissed the appeal.

The two principal legal issues before the Supreme Court were the same as those before the Court of Appeal, namely:

1. Whether and to what extent an arbitrator may accept appointments in multiple references concerning the same or overlapping subject matter with only one common party without thereby giving rise to an appearance of bias; and

2. whether and to what extent the arbitrator may do so without disclosure.

In order to address these points, the Supreme Court examined: (i) the duty of impartiality in the context of arbitration; (ii) whether an arbitrator is under a legal duty to disclose particular matters; (iii) how far the obligation to respect the privacy and confidentiality of an arbitration constrains his or her ability to make disclosure; and (iv) whether a failure to disclose such matters demonstrates a lack of impartiality. The Supreme Court also considered the timing for assessing the need to make a disclosure and the timing of assessing possible bias.

The duty of impartiality

The 'objective observer' test

The Supreme Court emphasised that it was not faced with an allegation of actual bias, but rather apparent bias. The well-established test under English law, as set out by the House of Lords (as was) in *Porter v Magill* [2001] UKHL 67 that the question is *'whether the fair-minded and informed observer, having considered the facts, would conclude that there was a real possibility'* of bias. Lord Hodge also emphasised a point made by the House of Lords in *Helow v Secretary of State for the Home Department and another* [2008] UKHL 62, namely that such observer will *'appreciate that the context* [i.e. the social, political or geographic context] *forms an important part of the material which she must consider before passing judgment'.* This emphasis on context was a key theme of the judgment.

The characteristics of international arbitration

The Supreme Court observed that the obligation of impartiality is a core principle of arbitration law, and that it (and the objective test outlined above) applies equally to all judges and all arbitrators. However, the Court held that, in applying the test to arbitrators, one must bear in mind the key differences between litigation and arbitration. In summary, these are:

1. Arbitrations are generally conducted in private and there is very limited public oversight of them. Arbitrators' duty of privacy and confidentiality militates against discovering the existence of an arbitration, in the absence of a disclosure. This *'puts a premium on frank disclosure'.*

2. Arbitrators are not subject to appeals on issues of fact and often not on issues of law.

3. Arbitrators, unlike judges, are nominated to act, and are remunerated, by the parties. For many arbitrators, their livelihood will depend to a significant degree on acting as arbitrators.

4. Arbitrators include lawyers and other professionals and experts in a wide range of business activities and trades, some of whom will have extensive experience of arbitration, whilst others may have very limited involvement. They also bring diverging views on ethically acceptable conduct from their different jurisdictions and legal traditions.

5. As a result of the private nature of most arbitrations, a party which is not common to multiple arbitrations has no means of informing itself of the evidence led, and legal submissions made, to other tribunals.

6. Within the field of international arbitration, there are differing understandings of the role and obligations of the party-appointed arbitrator. The Supreme Court made three observations in particular:

   a. First, although it is generally understood that as a matter of English law, all arbitrators (whether party appointed or independently appointed) are obliged to comply with the same high standards of impartiality, some legal systems take the view that a party-appointed arbitrator has a 'special role' in relation to his or her appointing party. This places a particular responsibility on the chair of the tribunal. The objective observer would take account of this context and the debate as to the role of a party-appointed arbitrator where that arbitrator is also acting as chair in a related case.

   b. Second, the objective observer would take account of the professional reputation and experience of an individual arbitrator, as *'an established reputation for integrity and wide experience in arbitration may make any doubts harder to justify'*. However, the weight placed on this fact will depend on the circumstances of the arbitration and whether one could expect the parties to be informed about the experience and past performance of arbitrators. This point adds helpful nuance to the relevance of an arbitrator's reputation and experience. The Court of Appeal had held that the fact the Arbitrator is a *'well known and highly respected international arbitrator'*, with very extensive experience, is *'material to the risk'* of him having unconscious bias. This risked creating a sliding scale in terms of the expectations on arbitrators of different calibre and experience, with less experienced arbitrators being held to a higher standard as regards disclosures than their more experienced colleagues. The Supreme Court's judgment expressly acknowledges that an arbitrator's experience is a relevant consideration, but ensures that it is not considered in isolation, but rather within the context of the specific arbitration and parties concerned.

   c. Finally, the objective observer would be alive to the possibility of parties making opportunistic or tactical challenges of arbitrator, in the hope of having a tribunal that (whilst unbiased) might be more predisposed towards their view.

The legal duty of disclosure

The Supreme Court confirmed that one way in which an arbitrator can avoid the appearance of bias is by making a disclosure of matters that could arguably be said to give rise to a real possibility of bias. The Supreme Court agreed with the Court of Appeal that making a disclosure in such circumstances is a legal duty, rather than merely good arbitral practice. Such duty is rooted in the arbitrator's statutory duty, in section 33 of the Act, to act fairly and impartially in conducting arbitral proceedings. Such duty gives rise to an implied term in the contract between the arbitrator and the parties that the arbitrator will act fairly and impartially. Without disclosures, parties will be unaware of matters that could give rise to justifiable doubts about an arbitrator's impartiality. Such a legal duty would, as submitted by the arbitral institutions that intervened in the appeal, underpin the integrity of English-seated arbitrations.

The duty was, as explained above, based on an objective test, whereas the IBA Guidelines on Conflicts of Interest (consistent with the rules of several arbitral institutions) provide that the duty is triggered by the existence of facts and circumstances that may *'in the eyes of the parties'* give rise to doubts as to the arbitrator's impartiality or independence.

The content of the disclosure

In terms of what must be disclosed, the Supreme Court echoed the Court of Appeal's formulation of the duty as extending to such matters *'known to the arbitrator'*, although it did not rule out the possibility of circumstances occurring in which an arbitrator would be under a duty to make reasonable enquiries in order to comply with the duty. The Supreme Court also considered the Court of Appeal's formulation of the duty to disclose matters that *'would or might'* give rise to justifiable doubts as to an arbitrator's impartiality, noting that an obligation to disclose a matter that *'might'* give rise to justifiable doubts arises only where the matter might *'reasonably give rise'* to such doubts. The Supreme Court had regard to arbitration commentary, the UNCITRAL Model law and the arbitration laws of other jurisdictions, concluding that it would be consistent with the *'international comparators'* for the English common law to develop from the basis of this *'would or might'* language, i.e. it is not necessary to show that the facts or circumstances *'would'* cause the objective observer to conclude that there was a real possibility the arbitrator was biased; it is sufficient that they *'might'* so conclude.

In summary, the legal duty to make a disclosure will arise where there exist matters that are relevant and material to the assessment of the arbitrator's impartiality and that could reasonably lead to an adverse conclusion.

The duty of privacy and confidentiality

Consistent with the private and confidential nature of arbitrations, arbitrators are subject to duties of privacy and confidentiality. An arbitrator may be required to give disclosure of information in one case that is subject to the arbitrator's duty of privacy and confidentiality that he or she owes to parties in another case. In such circumstances, the Supreme Court held, the disclosure can only be made where the parties to whom the duties are owed have given their consent. However, such consent may be express or inferred from the arbitration agreement, based on the context of the custom and practice in the relevant field. In the present proceedings, the Supreme Court was concerned with a 'Bermuda Form arbitration', where it is common practice for parties to appoint arbitrators with experience in interpreting the Bermuda Form policy on repeated occasions, including in arbitration relating to the same occurrence. The Supreme Court held that under English law, such multiple appointments must be disclosed, unless the parties have agreed otherwise.

The Supreme Court had regard to the widespread arbitration practice in English-seated arbitrations that arbitrators can disclose the proposal of appointment in a separate arbitration, and the identity of the common party seeking to make the appointment or nomination, without breaching his or her duty of privacy and confidentiality, and stated that the law *'can and should recognise the realities'* of such practice. The Supreme Court decided that in Bermuda Form arbitrations, an arbitrator may make disclosure of the existence of the arbitration and the identity of the common party without obtaining express consent because such consent of the common party can be inferred from its act in seeking to nominate or appoint the arbitrator.

Arbitrators will therefore need to have regard to the particular characteristics and circumstances and custom and practice in their field of arbitration in determining whether they need to seek express consent to make a disclosure in order to avoid breaching their duties of privacy and confidentiality.

Whether a failure to disclose can demonstrate a lack of partiality

The Supreme Court held that where an arbitrator has accepted an appointment in multiple arbitrations in circumstances which might reasonably give rise to justifiable doubts as to his or her impartiality, or is aware of other matters which might reasonably give rise to those doubts, a failure in his or her duty to disclose those matters to the party who is not the common party to the arbitrations deprives that party of the opportunity to address and perhaps resolve the matters which should have been disclosed. The failure to make a disclosure may demonstrate a lack of regard for the interests of the non-common party and may in certain circumstances amount to apparent bias.

The timing for assessing the need to make a disclosure

The Supreme Court agreed with the Court of Appeal that the determination as to whether an arbitrator has failed to perform a duty to disclose can only be made by reference to the circumstances at the time the duty arose, and during the period in which the duty subsisted. It cannot be retrospectively determined by reference to what was known to the objective observer only at a later date.

The timing of assessing possible bias

The Supreme Court had regard to the language of section 24(1)(a) of the Act, which refers to a power to remove an arbitrator where circumstances *'exist'* (in the

present tense) that give rise to justifiable doubts. This requires the courts to assess those circumstances as they exist at the date of the hearing of the application, by an application of the objective observer test, i.e. asking whether at the time of the hearing, the circumstances would have led the objective observer to conclude that there was a real possibility of bias.

Whether an arbitrator may accept appointments in multiple arbitrations concerning the same or overlapping subject matter with only one common party, without giving rise to an appearance of bias

The Supreme Court held that the acceptance of multiple appointments could be sufficient of itself to give rise to the appearance of bias, in the light of the inequality of knowledge between the common party and the other party or parties. However, whether it will give rise to the appearance of bias depends on the circumstances of the particular arbitration, including the custom and practice in arbitrations in the relevant field.

Whether and to what extent an arbitrator may accept the multiple appointments without making disclosure to the party who is not the common party

The Supreme Court held that the fact that an arbitrator has accepted appointments in multiple arbitrations concerning the same or overlapping subject matter with only one common party is a matter which may have to be disclosed, depending upon the customs and practice in the relevant field. Interestingly, the Supreme Court also pointed to specific fields, including maritime, sports and commodities where multiple appointments are a part of the process, which is known to and accepted by the participants, such that no duty of disclosure would arise in those circumstances. In this case, the Supreme Court decided that multiple appointments must be disclosed in the context of Bermuda Form arbitrations, unless the parties agree that such disclosures are not necessary. The need for disclosure is illustrated in particular by the fact that relevant information and the opportunity for communication with the Arbitrator was available to Chubb in one of the related arbitrations, but was not available to Halliburton.

Therefore, the related appointment might reasonably cause the objective observer, at the time of the second appointment, to conclude that there was a real possibility of bias. The Arbitrator was therefore under a legal duty to make a disclosure, which disclosure should have included: (i) the identity of the common party; (ii) whether the proposed appointment was to be a party-appointment or a nomination by a court or third party; and (iii) a statement of the fact that the second arbitration arose out of the same underlying subject matter. The common party's consent to this disclosure could be inferred.

By failing to make the disclosure, the Arbitrator breached his duty of disclosure.

The decision on Halliburton's application

However, the Supreme Court reiterated that the correct time for considering whether there is a real possibility of apparent bias is at the date of the hearing for removal of the arbitrator. It held that the objective observer would not reach such a conclusion, relying on five key points:

a. There was a lack of clarity in English law as to whether there was a legal duty of disclosure and whether disclosure was needed.

b. The time sequence of the three arbitrations may explain why the Arbitrator saw the need to disclose the existence of one arbitration but not the other.

c. The Arbitrator gave a measured response to Halliburton's challenge, explaining that the other two arbitrations would likely be resolved by a preliminary issue and so there would be no overlap in evidence or legal submissions, offering to resign from his appointments in the other arbitrations if the preliminary issue did not have such an effect.

d. There is no question of the Arbitrator having received any secret financial benefit.

e. There is no basis for inferring unconscious bias in the form of subconscious ill-will.

Therefore, the Supreme Court agreed with both Commercial Court and the Court of Appeal (for different reasons) that the objective observer, looking at the fact and circumstances that would have been known to him or her at the time of the hearing, would not conclude that there was a real possibility of bias. Halliburton's appeal was therefore dismissed.

Comment

The Supreme Court's decision provides clarification on the legal principles applicable to disclosures and the duty of impartiality. Its reasoning is grounded in a recognition of the practical realities of international arbitration.

The Supreme Court's decision also acknowledges the reality that one subject matter may comprise a multitude of contractual and other relationships between a number of parties, and so can lead to more than one claim and arbitration. Following the Court of Appeal's judgment, there remained unsatisfactory uncertainty around when the duty of disclosure would be triggered in such a situation, and when multiple appointments can be accepted without giving rise to the appearance of bias. It was necessary for the Supreme Court to engage with this issue and provide a clear answer, as such a situation is likely to arise again. However, the Supreme Court avoided creating an artificial bright line rule as to whether accepting appointment in multiple arbitrations would give rise to an appearance of bias, or whether an arbitrator would have to make a disclosure in such circumstances. Instead, the Supreme Court highlighted the need to take into account the custom and practice of specialist arbitrators and particular fields of arbitration when answering these questions.

Judges:
Commercial Court: Popplewell J.
Court of Appeal: Sir Geoffrey Vos C, Simon LJ, Hamblen LJ.
Supreme Court: Lord Reed JSC, Lord Hodge JSC, Lady Black JSC, Lord Lloyd-Jones JSC, Lady Arden JSC.

Expert witnesses: Conflicts of interest and multiple instructions

In *Secretariat Consulting PTE Ltd & Ors v A Company* [2021] EWCA Civ 6 the Court of Appeal upheld an injunction preventing an international expert services firm from acting for more than one party to an international construction dispute, despite involving separate experts in different locations contracting via separate legal entities. Given the rise of globalisation in the expert services industry, and for professional services more generally, this decision is likely to have considerable ramifications for the marketing of such services and the basis on which they are procured.

Facts

The developer of a petrochemical plant appointed a consultant to provide engineering, procurement and construction management ('**EPCM**') services in relation to the project. The developer also engaged a contractor for the construction of certain aspects of the project.

The contractor claimed against the developer in respect of additional costs incurred due to delays arising from the late release of certain designs. These were designs which the EPCM consultant was required to produce under its appointment. The developer's position was that it would seek to pass on to the EPCM consultant any liability it might have to the contractor.

The contractor commenced an ICC arbitration against the developer in relation to its claim (the '**Contractor Arbitration**'). The developer engaged a delay expert from 'Secretariat', an international expert services practice, to advise and act in connection with the arbitration. Some months later the EPCM consultant commenced its own arbitration against the developer for non-payment of fees (the '**EPCM Arbitration**'). The developer counterclaimed against the EPCM consultant in respect of delay and disruption to the project, including any liability it had to the contractor in the Contractor Arbitration.

Solicitors acting for the EPCM consultant subsequently notified the developer's solicitors that they were proposing to retain an expert from Secretariat to assist the EPCM consultant in the EPCM Arbitration. The developer objected on the basis that the Firm had

already been appointed by it in the Contractor Arbitration to consider many of the same issues which would arise on its counterclaim in the EPCM Arbitration.

The EPCM consultant and Secretariat sought to justify the acceptance of both retainers on the basis that the experts were appointed in different disciplines, based in different geographic regions and engaged through different companies within the Secretariat group. Information barriers had also been put in place to avoid any transfer of confidential information.

The developer successfully obtained an injunction from the Technology and Construction Court ('**TCC**') restraining Secretariat from providing expert services to the EPCM consultant in connection with the EPCM Arbitration.

Decision

The Court of Appeal rejected Secretariat's appeal and maintained the injunction. The Court of Appeal found it unnecessary, however, to uphold the TCC's finding as to fiduciary duties and expressed reservations as to the implications of such a finding. Instead, the Court of Appeal based its decision on an express clause of the appointment in the Contractor Arbitration which prohibited conflicts of interests. The clause recorded that Secretariat had *'confirmed you have no conflict of interest in acting for [the developer] in this engagement'* and that it would *'maintain this position for the duration of your engagement'*.

Although the appointment was addressed to and signed by a specific company within the Secretariat group, the Court of Appeal found that the conflict of interest clause was agreed on behalf of all companies within the group. One reason for this was that the conflict check said to be confirmed in the appointment had been carried out across all companies in the Secretariat group. Also of importance was the way in which the Secretariat business was managed and marketed:

'In considering what the parties would reasonably have understood, it is significant that companies within the group share the same name and are managed and marketed as a single global firm. They have a single website for the group as a whole, treating it as a single business in various jurisdictions, working as a team. It seems to me to be obvious that if an issue had arisen in the arbitration on which an employee in another company in the group had particular experience or expertise, both parties would naturally have expected that experience or expertise to be available to A Co as the client. … In these circumstances the undertaking given by Secretariat Consulting not to accept instructions which would give rise to a conflict of interest can readily – and in my judgment must – be understood as having been given on behalf of the group as a whole'.

The Court of Appeal agreed with the TCC that Secretariat had placed itself in a position of conflict by accepting an appointment for the consultant in the EPCM Arbitration. Whilst the Court of Appeal acknowledged the question was a matter of degree, and that expert witnesses might readily act for and against the same company in disputes involving separate projects or transactions, it considered this to be a clear case. The appointment in the EPCM Arbitration involved an overlap *'of parties, role, project, and subject matter'*. The interests of the consultant in the EPCM Arbitration were opposed to the developer's interests such that the two Secretariat experts could easily find themselves supporting opposite positions on the same or similar issues.

Comment

This decision has particular relevance to the increasing trend of globalisation among expert services firms and to professional services firms more generally. Such a trend is particularly notable in the energy, construction and engineering spheres. Expansion is often the result of mergers between existing local practices, bringing with it the very real potential for instructions from multiple parties to an international dispute. As in the present case, such merged entities are typically marketed as a single firm with a unified management structure and a 'global presence'.

The Court of Appeal's reasoning poses a clear risk for such a business that, undertakings to avoid conflicts of interests, will be interpreted to apply globally across all of its companies. The Court of Appeal acknowledged that appointments could be drafted to avoid this result, with such undertakings being limited to a specific company only. However, it also noted: *'Whether, if it does so, it will secure the instruction, is another matter'*.

The Court of Appeal's reluctance to extend fiduciary obligations into expert witness appointments will be welcomed by many. The TCC's reasoning on this point was potentially applicable across the board to expert appointments of a general nature to assist a party in court or arbitration proceedings. Fiduciary obligations extend beyond mere duties of loyalty and, if upheld by the Court of Appeal, this is likely to have been an area of uncertainty productive of further disputes.

By contrast, the Court of Appeal's decision is firmly rooted in the individual circumstances of the Secretariat appointment and the terms agreed with the developer. In substance, the Court of Appeal's decision seems to be that when the express terms of the appointment were read against the factual matrix of Secretariat's marketing the proper construction and interpretation of the appointment was (i) the conflicts undertaking was given in respect of the entire group and (ii) that the signatory was acting as agent for the entire group. Such circumstances may, of course, differ in future cases. The basis of the Court of Appeal's decision means that it is open to international professional services firms to ensure that the express terms of their engagement avoid the conclusions reached in this case. In doing so there are two issues to address, first, whether any conflicts warranty or undertaking, is given in respect of the signatory or the entire group, and second, whether the signatory executes the terms of engagement for the entire group. Companies and firms wishing to avoid a similar result will need to deal with both of these issues, as the first might give rise to a liability for the signatory (even for conflicts generated by non- signatories) and the second a liability for non-signatories.

Judges: Coulson LJ, Males LJ, Carr LJ.

When is an expert's error a 'manifest error'?

In *Flowgroup plc v Co-operative Energy Ltd* [2021] EWHC 344 (Comm) the Commercial Court dismissed a challenge to an expert determination on an alleged 'manifest error'. As expert determination clauses are widely used in the energy sector and often limit challenge to a 'manifest error' (and there is frequently a debate about what that means), the decision of the Commercial Court provides useful guidance on what constitutes manifest error in the context of expert determinations.

Facts

Flowgroup plc ('**Flowgroup**'), the claimant, was the seller of the entire allotted and issued share capital of its wholly owned subsidiary, Flow Energy Limited (the '**Target**') pursuant to an Acquisition Agreement dated 10 April 2018 (the '**Agreement**'). The Target was a supplier of gas and electricity. Co-operative Energy Ltd ('**CEL**'), the defendant, was the buyer of the Target.

By Clause 3 of the Agreement, the purchase price was subject to a working capital adjustment, to be determined in accordance with detailed provisions contained in Schedule 9. The parties were unable to agree on the amount of the working capital adjustment and the matter was referred to expert determination, pursuant to Part A of Schedule 9. That determination was delivered in the form of a report (the '**Report**') dated 8 March 2019 by a partner at Ernst & Young LLP (the '**Expert**'). The Report was largely favourable to the buyer, and the seller duly challenged the Expert's findings.

The Agreement provided that the Expert's written decision on the matters referred to her will be final and binding in the absence of 'manifest error' or fraud. The issue before the Commercial Court was whether there was such 'manifest error' in the Report.

Decision

The meaning of 'manifest error'

The parties agreed that one aspect of the test for 'manifest error' was *'an error which is obvious or easily demonstrable without extensive investigation'* (*Amey Birmingham Highways Ltd v Birmingham City Council* [2018] EWCA Civ 264), but disagreed over its application. Flowgroup argued in favour of what it termed a 'visibility' test in the sense that the error must be capable of being demonstrated from the face of the record. CEL relied on observations made by Simon Brown LJ in *Veba Oil Supply & Trading Gmbh v Petrograde Inc* [2001] EWCA Civ 1832 to the effect that 'manifest errors' were *'oversights and blunders so obvious and obviously capable of affecting determination so as to admit no difference of opinion'*.

The Commercial Court considered that the *Veba Oil* test was not inconsistent with the test arising out of *Amey Birmingham Highways Ltd* and that it identified *'an important and necessary component of the 'manifest error' exception'*. The Commercial Court cited three reasons: (i) it was shown no case in which the Veba Oil test had been disapproved; (ii) it had been applied in other first instance decisions; and (iii) it was consistent with the textbooks, including Lewison on the Interpretation of Contracts. Reverting to what the Commercial Court termed *'a more general point of principle'*, it went on to observe that the circumstances in which an expert's determination can be challenged are tightly circumscribed: *'The reason for this is that where parties have agreed to subject their dispute to an expert determination, that is what they are entitled to. A manifest error exception allows recourse to the Court but in necessarily confined circumstances'*.

As for the *'visibility'* test advocated by Flowgroup, the Commercial Court dismissed this concluding that it *'would provide little content to the word 'manifest' and in practice no real filter to the scope of any challenge, with the danger that the Courts would simply become an alternative forum for the party dissatisfied with the expert's conclusions'*.

Manifest error and mistakes in law

Flowgroup also argued that where the expert's decision was on a matter of contractual interpretation, there was only one correct interpretation. Therefore, if the expert got it wrong, this amounted to a manifest error. In effect, the 'manifest' qualification was ignored or automatically satisfied.

In this respect, the Commercial Court considered that the issue was one of jurisdiction. It distinguished between two scenarios:

1. First, if an expert was engaged to determine a matter of contractual interpretation, the Commercial Court saw no reason why a challenge should not have to circumvent the 'manifest error' test.

2. Second, that is to be distinguished from the situation where the role of the expert is more circumscribed and where different considerations might therefore arise. The court will intervene if *'the decision-maker has gone outside the limits of his decision-making authority'*.

Therefore, the correct approach turned on the scope of the expert's engagement.

The Agreement was clear that the engagement of the Expert was of a broad and expansive nature and that it included, where necessary, the mandate to determine issues of contractual interpretation, insofar as they were necessary to resolve the matters in dispute between the parties. The dispute was ultimately one of accounting, in the sense that the product of the Expert's engagement was to be a determination for the purpose of a revised 'Completion Statement' with the correct figure for 'Completion Working Capital'. In the event, at least part, and arguably a large part, of the difference between the parties was a dispute over the meaning of the relevant Agreement provision. It is apparent from the written submissions that both parties did in fact seek the resolution by the Expert of central matters of interpretation in their favour. Nor was it a surprising conclusion that this is what the Agreement provided for. It was entirely understandable that the parties should wish for an expert accountant to resolve necessary issues of contractual interpretation in an accounting context.

The Commercial Court duly found in favour of the CEL/ the buyer and dismissed the claim.

Comment

The decision of the Commercial Court raises two interesting issues (i) the scope of the expert's jurisdiction and whether it extends to findings of law and (ii) the content of 'manifest error' in an expert determination clause.

Jurisdiction

In relation to jurisdiction, *Kendall on Expert Determination*, 5th Ed., explains that an analysis of the question whether an issue of law is within the exclusive jurisdiction of the expert is complicated by the fact that an erroneous decision on an issue of law may be characterised in two different ways:

— A decision on a point which the parties agreed should be decided by the expert and which is accordingly a decision falling within the expert's jurisdiction; and

— A failure to carry out the task which the expert was appointed to carry out, and therefore a decision made in excess of jurisdiction or a material departure from instructions.

The law suggests that parties can, by the use of appropriate wording in their contract, confer on the expert exclusive jurisdiction to decide questions of interpretation of the contract. As a result, a decision based on an erroneous interpretation of the contract *'will not invariably be treated by the courts as being a material departure from instructions or being made in excess of jurisdiction'*. However, much will turn on the words used by the parties in conferring jurisdiction upon the expert.

Manifest error

As expert determination clauses in the energy sector often provide recourse to challenge the determination only in the event of a 'manifest error', and there is frequently a debate about what that means, the judgment provides useful guidance on what constitutes manifest error in the context of expert determinations. The Commercial Court has reiterated that the circumstances in which an expert's determination can be challenged are tightly circumscribed. In relation to provisions allowing challenge for a 'manifest error', anything short of *'oversights and blunders so obvious and obviously capable of affecting determination so as to admit no difference of opinion'* may well not satisfy the test for 'manifest error'.

Judge: Mr Beltrami QC.

The OGA and arbitration under the Model Clauses

In *AT, DV, SD, HG v Oil and Gas Authority* [2021] EWHC 1470 (Comm) the Commercial Court decided two significant issues for oil and gas industry licensees as regards challenging decisions or actions by their regulator, the Oil and Gas Authority (the '**OGA**'). First, whether a dispute in respect of a proposed course of action by the OGA falls within the scope of the arbitration agreement contained in the Model Clauses – so that court remedies under the Arbitration Act 1996 are available, including urgent orders such as injunction before arbitration proceedings have been commenced; and, second, the balance that needs to be struck between the OGA's exercise of its decision making powers and the significant harm this might cause where the result is disclosure of commercially sensitive or confidential information.

Facts

As is commonly the case for an application made in terms of the Arbitration Act 1996, the published judgment does not identify the parties bringing the claim. It has also been heavily redacted by agreement between the parties and with the approval of the Commercial Court, presumably to avoid disclosing any aspect of the commercially sensitive information that the claimants sought to protect. That includes the identity of the licence(s) in question, the nature of the OGA's apparent concerns or the notice it proposed to serve, the parties with whom the OGA proposed to communicate, or the reasons for the OGA's intended approach. The full factual context is therefore difficult to discern, but the Commercial Court's considerations in reaching its decision are otherwise set out in full.

From the decision, it is apparent that:

— The OGA proposed to serve a notice on the claimants in respect of concerns held by the OGA – paragraphs 2, 3 and 4 of the notice are described in the judgment as 'material' for the purposes of the Commercial Court's consideration, and are set out in the redacted judgment in the following terms:

'2. The OGA considers it appropriate, before serving the notice, to give you the opportunity to make any representations that you wish on the content, and/or propose any commitments or other mitigations that may address the OGA's concerns, as expressed herein.

3. ***Any such representations and/or proposals and the like shall be sent to the OGA by*** *[date redacted by agreement between the parties].*

4. For the avoidance of doubt, the OGA is under no legal obligation to provide you with an opportunity to make representations on whether the OGA should (a) serve such a notice or (b) send a copy of this [notice] to [redacted by agreement between the parties] but considers that it is appropriate to do so in this particular case…'

— Before serving the notice, the OGA delivered the notice to the claimants under covering correspondence which appears to have invited representation on how they may address the OGA's concerns: *'The OGA considers it appropriate to give you the opportunity to make any representations that you wish, and/or to propose any commitments or other mitigations that may address the OGA's concerns. For the avoidance of doubt, the OGA does not consider that it is under any legal duty to do this, but considers it appropriate to do so in this case. Any such representations and/or proposals should be sent to the OGA by [date redacted by agreement between the parties]'.*

— Once the deadline contained in the covering correspondence had passed, the OGA intended to circulate the notice (or a redacted version of it) to third parties.

The arbitration agreement on which the claimants relied is contained in the Model Clauses that apply to a Licence granted in accordance with the Petroleum Act 1998 (or its predecessor legislation), by virtue of the Petroleum Production Regulations 1966 or the Petroleum Licensing (Production) (Seaward Areas) Regulations 2008. The parties agreed that the Commercial Court should determine the application on the basis that the relevant terms were those set out in the Model Clauses contained in Schedule 1 to the 2008 Regulations. Model Clause 43(1) provides:

'If at any time any dispute, difference or question shall arise between the Minister or the OGA and the Licensee as to any matter arising under or by virtue of this licence or as to their respective rights and liabilities in respect thereof then the same shall, except where it is expressly provided by this licence that the matter or thing to which the same relates is to be determined, decided, directed, approved or consented to by the Ministers or the OGA, be referred to arbitration…'

Although it is difficult to be certain from the limited information contained in the judgment, it seems that the claimants were very concerned at the prospect that the OGA would circulate the notice to third parties. The claimants contended that the OGA's proposed course of action was:

1. unlawful, in the public law sense; and/or

2. in breach of terms to be implied into the relevant Licences; and/or

3. irrational, in the public law sense.

Relying on the arbitration agreement, the claimants asserted that a dispute had arisen between them and the OGA that fell within the scope of the arbitration agreement, such that the claimants were entitled to an order restraining the OGA from its proposed course of action in terms of section 44(3) of the Arbitration Act 1996 (broadly speaking, section 44(3) permits the Court to make certain orders in support of arbitration proceedings, including urgent orders before arbitration proceedings have been commenced). The parties agreed that, if the Commercial Court concluded that the Arbitration Act route was not available to the claimants (because the dispute did not fall within the scope of the arbitration agreement), then the application should be determined as if it were a claim for interim relief in a judicial review claim – in that event, judicial review would be the only available remedy and the claimants had offered an undertaking to commence judicial review proceedings within a very short period if that was the Commercial Court's conclusion.

The OGA resisted the application on two main grounds:

1. The arbitration agreement did not apply to the dispute in question, because either:

   a. It was not a dispute '*arising under or by virtue of*' the Licences or pertaining to the '*respective rights and liabilities*' of the parties thereunder; or, alternatively

   b. the dispute fell within the exception in Model Clause 43(1) in respect of a '*matter or thing… to be determined, decided, directed, approved or consented to by the Ministers or the OGA…*'; and

2. in all the circumstances, the balance of convenience test was not met, so that an injunction should not be granted.

Decision

Arbitration Agreement

Although the Commercial Court considered various preliminary and potential arguments (not all of which had been raised by the parties), the application turned on the construction of the arbitration agreement and whether the dispute fell within its scope, properly understood.

The Commercial Court did not accept the OGA's contention that this was not a dispute *'arising under or by virtue of'* the Licences or as to the *'respective rights and liabilities'* of the parties thereunder. In principle, the arbitration agreement applied, subject to the express exception it contained. The language used was wide and the dispute plainly fell within its terms. The fact that the dispute was concerned in essence with public law principles did not take it outside that scope – although the remedies available to the Administrative Court (in a judicial review application) would be different to those available to an arbitrator, an arbitrator could nonetheless frame an award in the form of a declaration or a prohibitory order so as to prevent the OGA from proceeding as proposed if that was the outcome of the process. It was also not sufficient to take the matter outside the scope of the arbitration agreement that the OGA's proposed course of action was not expressly permitted by the Licence: *'The process that the OGA has adopted is incidental or ancillary to the exercise of its powers…and as such the dispute as to its fairness is one that arises either by virtue of the Licence or as to the OGA's rights in respect of it'.*

The key question was therefore whether the exception identified in the arbitration agreement applied i.e. whether the subject matter of the dispute was a *'matter or thing'* to be *'determined, decided, directed, approved or consented to'* by the OGA in terms of a power conferred on the OGA by the Licence. In that regard, the Commercial Court considered that:

— No distinction could be drawn between operative provisions of the Licence and matters that raise public policy issues. The only distinction for the purposes of the exception was between matters expressly to be decided by the Minister or the OGA, and those that were not. That distinction made sense, because decisions made by a public authority (including the OGA) are generally capable only of challenge on public law grounds and best dealt with by means of judicial review, whereas other disputes that did not involve such a determination would not appropriately be dealt with in that way.

— That said, the wording of the exception was broad, so that it was not limited to the actual exercise of an express power under the Licence, but it was sufficient that the dispute 'related to' a matter or thing to be determined by the OGA – it included not only a decision to exercise its power or discretion, but also decisions by the OGA as to how to exercise that power or discretion, including as regards consultations prior to exercising a power.

Relief to be granted

As it was decided that the Arbitration Agreement did not apply, the Commercial Court proceeded to consider what relief ought to be granted on the claimants' undertaking to issue judicial review proceedings. In deciding whether an interim injunction should be granted the test to be applied is a modified version of the familiar *American Cyanamid* test - namely (i) is there a serious issue to be tried; and (ii) does the balance of convenience require an order to be granted. The OGA did not assert that there was not a serious issue to be tried, therefore, the only remaining question was as to the balance of convenience.

The Commercial Court decided that there was a significant risk the claimants would suffer *'serious and irreparable harm'* if the OGA shared the notice with any third parties. The notice was not framed in neutral terms and, in sharing even a redacted version of it, recipients would likely act in their own best interests which would put the claimants at risk of significant commercial damage. There was also a significant risk of further dissemination of the information contained in the notice. Additionally, questions of fairness arose – in circulating a draft of its proposed decision and inviting comment, there was a suggestion that the OGA had already reached a provisional conclusion. Even if the OGA wished to consult with third parties before reaching its decision and conducting a final meeting with the claimants, it could have done so in a neutral way rather than taking the approach it proposed. Ultimately, the consequence to the OGA of the injunction being granted was a question of delay, and that could have been avoided had the OGA adopted a more objectively neutral approach.

Therefore, the balance of convenience test was met in favour of the claimants. However, the Commercial Court also expected the claimants to undertake to commence judicial review proceedings within three days of the date of the judgment, and to ask for that application to be dealt with on an expedited basis.

Comment

This is a rare example of a challenge to the OGA's exercise of its broad discretion in how it exercises its considerable powers, and an unusual test of the application of the dispute resolution provisions contained in the Model Clauses. The OGA's actions and decisions have potential to cause significant commercial impact on a Licensee, for example in disseminating confidential or commercially sensitive information (including as to the OGA's concerns about particular actions or activities) and in associated potential reputational risk. The OGA has always indicated that it is alive to those risks, and following this decision it may be even more cautious to ensure that the processes it adopts are fair and that its communications are framed objectively and in neutral terms, particularly where it is communicating with third parties.

The decision of the Commercial Court emphasises that, although the Model Clauses contain arbitration agreements, not all issues relating to disputes concerning the Model Clauses require or permit reference to arbitration. Disputes in respect a *'matter or thing… to be determined, decided, directed, approved or consented to by the Ministers or the OGA…'* remain for the Courts to decide. In addition to the benefit that a Court judicially reviewing a determination, decision approval or consent will have powers additional to an arbitral tribunal, it also ensures transparency and consistency decision making processes by a public authority – which private arbitration is, perhaps, not best placed to ensure.

Judge: HHJ Pelling QC.

Challenging bond calls on international projects: English courts vs Emergency Arbitrators

In *Shapoorji Pallonji & Company Private Ltd v Yumn Ltd* [2021] EWHC 862 (Comm), the Commercial Court has refused an application for an injunction requiring a beneficiary under an on-demand bond to withdraw its demand and refrain from making further demands pending the decision of an Emergency Arbitrator. The decision provides important guidance as to the relationship between Emergency Arbitration proceedings and interim relief from the English courts. The decision also comments on the extent to which the approach of an Emergency Arbitrator may differ from that taken by the English courts when determining questions under a contract governed by English law.

Facts

Yumn Ltd ('**YL**') appointed Shapoorji Pallonji and Company Private Ltd ('**SPC**') (and some of its related group companies) to construct a power plant in Rwanda. The project agreements were based on the FIDIC form, were all subject to English law and provided for disputes to be resolved by ICC arbitration seated in Singapore.

SPC gave an on-demand performance bond in the sum of USD 32.2m. The bond, which was issued by Standard Bank, was subject to English law and the jurisdiction of English courts. Other than a prescribed form of demand and the requirement for demands to be delivered within business hours, the bond did not stipulate any other conditions precedent for a valid demand.

The original Date for Taking Over of the Works was 23 February 2020. Significant delays occurred for which SPC claimed extensions of time. YL refused to extend time on the basis that SPC had failed to notify its claims with the periods required by the contracts.

On 24 February 2021, YL made a written demand under the project agreements for payment of delay liquidated damages which, in the absence of an extension of time, had reached their maximum limit under the contracts. In the absence of payment, YL demanded the full amount of the performance bond from Standard Bank on 23 March 2021 citing, among other things, SPC's liability for delay liquidated damages.

Standard Bank informed SPC of the demand on 26 March. SPC immediately requested that YL withdraw the demand and a sent solicitors' letter alleging that the demand was *'fabricated'*. SPC also commenced two sets of proceedings seeking to prevent payment under the bond:

— ICC Emergency Arbitrator proceedings seeking orders against YL to suspend its demand against Standard Bank and prevent any further demands being made; and

— An application to the English Commercial Court under section 44 of the Arbitration Act 1996 for orders that YL withdraw its demand under the bond and refrain from making further demands pending the order of the ICC Emergency Arbitrator.

The Commercial Court delivered judgment swiftly, within 8 days of SPC's application and prior to any consideration of the matter by the Emergency Arbitrator.

Decision

Relief pending Emergency Arbitration

Although SPC maintained its position that YL's demand was fraudulent, its primary position before the Commercial Court was that the propriety of YL's demand was a matter for the Emergency Arbitrator and, thereafter to the extent necessary, a fully constituted arbitral panel under the ICC rules. SPC therefore submitted that the Commercial Court should grant orders preserving the status quo until the Emergency Arbitrator could decide on the issue. In support of this argument, SPC claimed that an Emergency Arbitrator was likely to adopt a less stringent approach than that taken under English law to the question of whether YL should be compelled to withdraw their demand and/or be restrained from making further demands.

For the purpose of this argument, the Commercial Court was content to assume that the propriety of YL's demand was caught by the arbitration agreement governing the project agreements. However, the Court considered it arguable that disputes as to YL's entitlement to make a demand under the bond might fall outside the arbitration agreement, given the inclusion with the bond of an English law and jurisdiction clause and the bond being in a form which was annexed to the project agreements.

The Commercial Court was also prepared to accept that an Emergency Arbitrator might arguably adopt a different approach to that adopted by the English courts. However, the Commercial Court noted that English law was the law governing both the project agreements and the performance bond and, accordingly, the fact that Singapore law (i.e. the curial law governing the arbitration proceedings) appeared to adopt a different approach to attempts to restrain the enforcement of bonds was immaterial. The Commercial Court also noted that whilst it was arguable that an ICC Emergency Arbitrator might apply procedural rules and principles that are different from and independent of those applied by an English court, that did not *'lead necessarily to the conclusion that the emergency arbitrator will grant the order sought by SPC when a court in England would not'*. The principles of substantive English law governing the enforcement of on-demand bonds would *'apply irrespective of whether the issues are being considered by a court in England or by an international arbitrator required to apply substantive English law to the dispute between the parties'*.

Having nevertheless assumed the above two matters in SPC's favour, the Commercial Court found it would not be appropriate to grant relief under section 44 merely to preserve the *status quo* pending the determination of SPC's application to the Emergency Arbitrator. The Commercial Court considered that the same English law principles as to the enforcement of on-demand bonds should apply regardless of whether interim relief was sought in aid of an arbitration or generally in relation to court proceedings (under section 37 of the Senior Courts Act 1981). It also emphasised SPC's delay in commencing Emergency Arbitration proceedings. The dispute over extensions of time was longstanding and YL's formal demand for payment of delay liquidated damages had been issued a month prior to the demand under the bond. As the Court noted: *'It was open to*

SPC to refer the failure of YL to grant any of its applications for extensions in time to arbitration as soon as those applications had been refused and the contractual mechanisms for resolving such disputes had been exhausted and in that reference to seek an order from an EA from restraining YL from calling on the demand bond pending the resolution of that dispute. It chose not to do so'.

The English law principles

Having rejected SPC's primary position, the Commercial Court considered whether SPC was entitled to have YL withdraw its demand under English law. It noted there was little prior authority on the principles governing applications to require the withdrawal of demands, but guidance could be taken from cases dealing with other bond enforcement scenarios.

In relation to applications to restrain underwriters, such as the bank in this case, from complying with their obligations under an on-demand security, in the absence of a dispute as to the formal validity of the demand a Court would only grant an injunction where it is established that *'the only realistic inference is that (a) the beneficiary could not honestly have believed that it was entitled to make a demand for payment and (b) the bank was aware that the demand was fraudulent'*.

In relation to applications to restrain a beneficiary, the Commercial Court explained that an injunction would generally only be granted to restrain a beneficiary from breaching an express or implied restriction contained in the underlying contract. In this case, however, there were no express conditions precedent to a demand and no implied obligations were asserted. Short of such restrictions, an application to restrain a beneficiary would need to satisfy the same test for fraud quoted above applicable to applications against underwriters. Provided these requirements were met, there was no reason why a beneficiary could not be forced to reverse the steps it has taken to enforce its rights under the instrument in question (i.e. through an order requiring the withdrawal of a demand).

In the present case, SPC had not come close to satisfying the fraud exception. It had not submitted any evidence to challenge YL's belief that SPC's failure to comply with the notification requirements of the project agreements had invalidated its claims to extension of time. There was

nothing to suggest the dispute was *'anything other than a delay dispute between an employer and contractor of the sort that arises on a regular basis in the civil engineering and construction sectors'*.

Comment

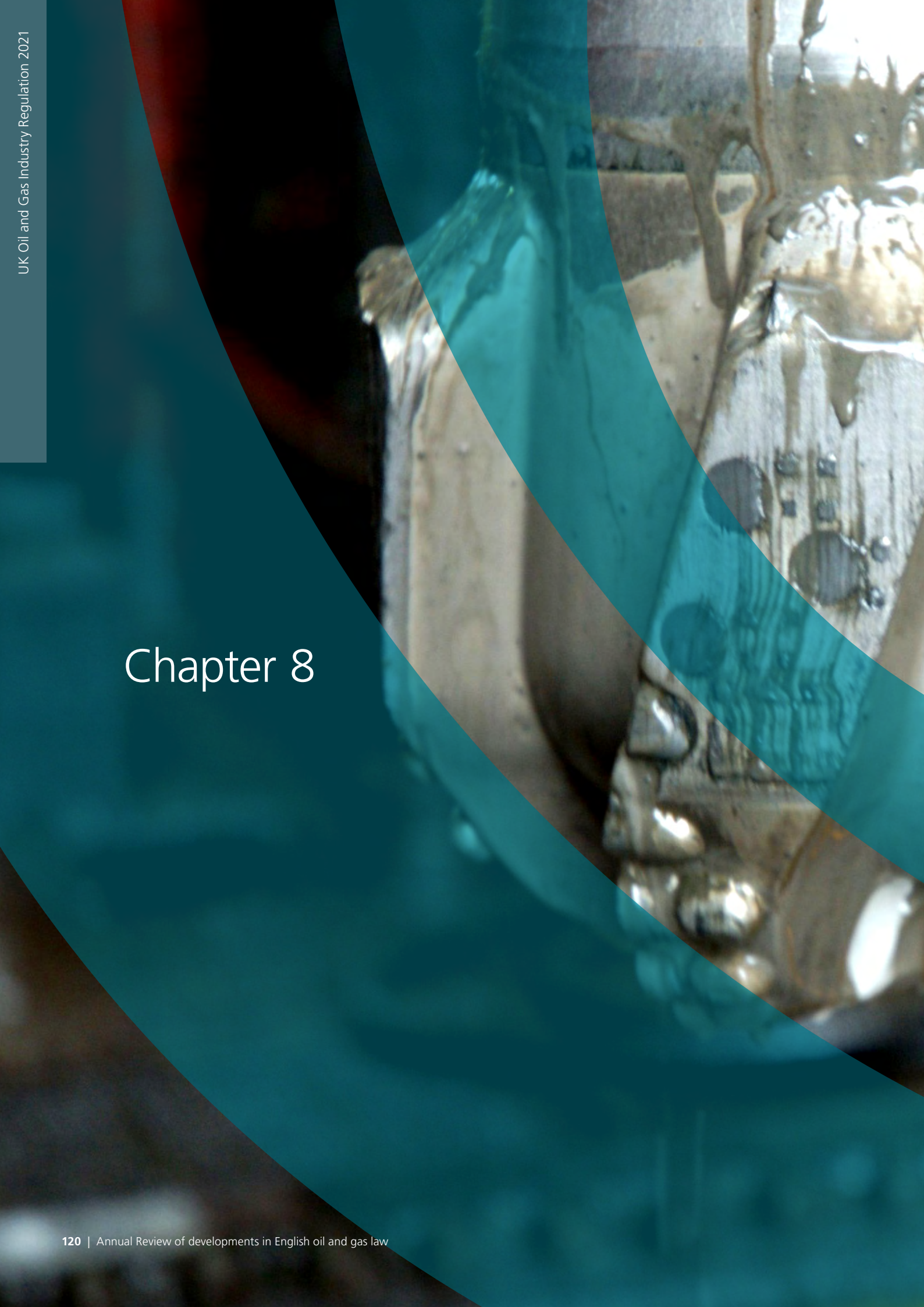
Emergency Arbitrator proceedings are still a relatively new procedure in the arbitral world and guidance as to the relationship between such proceedings and interim relief from the English courts under section 44 of the Arbitration Act has been scant. This decision therefore provides valuable guidance as to the approach to be taken under section 44 where relief is sought in relation to calls under on-demand securities. The Commercial Court's refusal to defer to Emergency Arbitration has considerable strategic implications for parties involved in such disputes.

The arguments made by SPC suggest a perception that Emergency Arbitration provides a more lenient forum for contractors wishing to challenge the enforcement of an on-demand security. The Commercial Court's comments as to the potential for Emergency Arbitrators to apply a more lenient approach are also of interest.

The comments are likely to be quoted in support of the application of English law principles by Emergency Arbitrators where English substantive law is applicable to the underlying contracts. On the other hand, the Commercial Court was concerned not to make a *'pre-emptive challenge'* to the decision of the Emergency Arbitrator and noted that *'he must be left to do his work as he considers appropriate'.*

Somewhat more significant is the Commercial Court's suggestion that a general arbitration clause may not extend to disputes in relation to an on-demand bond where that bond has applicable law and jurisdiction clauses and its form is annexed to the underlying construction contract. This is a fact pattern which is likely to apply to a great many cases and beneficiaries may well seek to rely on these comments to resist Emergency Arbitration proceedings commenced by a contractor.

Judge: HHJ Pelling QC..



Chapter 8

UK Oil and Gas Industry Regulation 2021

Introduction

Notwithstanding the challenges raised by the pandemic, the period to July 2021 since our last review has been busy for the Oil and Gas Authority (the '**OGA**'). The introduction of the new OGA Strategy highlighted a shift in focus recognising the ongoing energy transition and imposing an obligation on the oil and gas industry to plan and conduct activities in a way that supports 'net zero'. It also re-emphasised the importance placed on collaboration between relevant persons within the industry and extended that to potential industry entrants and to the supply chain. The OGA's decision making is beginning to be tested, including various court challenges from environmental protestors. In recognising the impact of the COVID-19 pandemic, the OGA took various pragmatic steps to try to support the industry, including increased flexibility around compliance with licence commitments and a focus on encouraging operators and licensees to settle invoices promptly to support cash flow in the supply chain. 'Business as usual' activities have also continued, including the launch of the 32nd licensing round, release of further seismic data to the industry and further work on the 'National Data Repository' as well as the introduction of two new 'Asset Stewardship Expectations' and a new 'Decommissioning Strategy'.

Net Zero

OGA Strategy

Part 1A of the Petroleum Act 1998 requires the OGA to produce a strategy to enable the principal objective of maximising economic recovery of UK petroleum to be met, and this must be reviewed every four years. The strategy is central to the system of regulation implemented by the OGA as it is binding on 'relevant persons', which includes offshore licence holders, operators and owners of offshore infrastructure as well as the OGA itself. The first strategy (the '**MER UK Strategy**') was introduced in 2016 and so 2020 saw the first four yearly review, which included a consultation process and led to the introduction of the revised strategy (the '**OGA Strategy**') in February 2021.

Since the MER UK Strategy came into effect, there has been an evident shift in opinion surrounding climate change with a new focus on the industry's *'social licence to operate'* and its role in achieving net zero. While the structure of the OGA Strategy remains similar to that of the MER UK Strategy (comprising a Central Obligation, with a number of Supporting Obligations, Required Actions and Safeguards) a change of emphasis is evident with the OGA Strategy embedding a range of new net zero obligations that reflect the ongoing global energy transition.

The key change is the expansion of the Central Obligation to include a requirement to reduce greenhouse gas emissions in support of the net zero target. The Central Obligation remains to *'secure that the maximum value of economically recoverable petroleum is recovered from the strata beneath relevant UK waters'* but now also includes an obligation in doing so to '*take appropriate steps to assist the Secretary of State in meeting the net zero target, including by reducing as far as reasonable in the circumstances greenhouse gas emissions from sources such as flaring and venting and power generation, and supporting carbon capture and storage projects'*. While the OGA considers that the net zero target is now an integral part of MER UK, this new second limb applies only *'as far as is reasonable in the circumstances'*, to try to take account of the fact that the obligation needs to be applied to real situations. What is 'reasonable' will vary and the OGA has noted that it considers it is not appropriate to define more specifically what this means.

In addition, the Development, Asset Stewardship and Decommissioning Supporting Obligations have all been updated to incorporate the new net zero focus, and a new Supporting Obligation was introduced in relation to carbon capture and storage ('**CCS**') projects. Consequently, in conducting relevant activities, relevant persons *'must have regard to [CCS] projects'* where there is *'a reasonable prospect of any such project being developed'*. That includes collaborating with those planning and carrying out such projects, permitting access to infrastructure for those projects on fair, reasonable and non-discriminatory ('**FRAND**') terms and negotiating that access in good faith and in a timely fashion.

Separately, the definition of *'economically recoverable'* was amended to make it clear that carbon emissions and carbon costs assumptions should be included within economic assessments of project or option appraisals. The OGA expects that the societal costs of greenhouse gas emissions will be included when undertaking economic assessments.

Net Zero Stewardship Expectation

On 15 March 2021 the OGA published its new 'Stewardship Expectation 11 – Net Zero' to assist the industry in understanding how the OGA expects implementation of these new net zero obligations to be carried out across a company's entire organisation, creating a culture of greenhouse gas emissions reduction within the UKCS. Companies must evaluate performance against industry and government targets

and align their approach accordingly. This Expectation also makes clear that greenhouse gas emissions impact must be monitored through all lifecycle phases of a project, supported by, amongst other things, improved energy efficiency, continued focus on maintenance and a high level of production efficiency.

UKCS Energy Integration Report

In an effort to push industry to move quickly and to focus effectively on achieving the industry's commitment to becoming a net zero emissions basis by 2050, the OGA published its final report on UKCS energy integration in August 2020. The OGA's 'Energy Integration Project', which began in early 2019, has explored how different offshore energy systems could be co-ordinated across the UKCS for environmental and efficiency gains. The project made a number of recommendations to realise the vision of the UKCS as a critical enabler for net zero. It considers that carbon capture usage and storage ('**CCUS**') is likely to be essential if the UK is to meet its obligations under the Paris Agreement and the net zero target under the Climate Change Act. To deploy CCUS at scale, a UK infrastructure network will need to be developed to transport and permanently store carbon dioxide offshore. The re-use of oil and gas assets has the potential to significantly reduce the cost of developing that network and its carbon footprint. The report concluded that oil and gas infrastructure, capabilities and supply chain can contribute significantly to offshore renewables expansion and UK net zero, with integration bringing a possible 30% contribution towards the country's overall net zero target, primarily through platform electrification, CCUS, blue and green hydrogen, and potentially another 30% of the 2050 target by virtue of these technologies supporting the expansion of offshore renewables. It also identified potential benefits for oil and gas owners and operators, including opportunities to maximise the economic life of their assets, and to potentially reduce or transfer decommissioning costs.

The OGA ESG Task Force

The ESG Taskforce is a cross-industry discussion group, organised by the OGA, which was asked to identify a small set of ESG metrics which are important to investors and can be easily reported on by companies. The ESG Taskforce focused on the 'E' of ESG: the environmental aspects of reporting. It outlined a number of expectations which it considered operators and licensees should meet in relation to disclosure and investor reporting, including disclosure of climate related data. Although many operators and licensees already meet these expectations, the OGA has stated that it intends to support widespread adoption by working with trade associations and groups including OGUK. The OGA expects this will also help the industry to prepare for the mandatory reporting requirements which the UK Government announced are expected to be in place across the economy by 2025, with some requirements coming into force in 2023.

The ESG Taskforce has concluded that operators and licensees should spend the next year discussing best practice of how to report against the identified metrics with a view to aligning industry to a minimum standard of reporting using key agreed metrics, and should be ready to report in Q1 2022 alongside the publication of 2021 full year financial reports.

Collaboration and Corporate Governance

As well as setting out obligations that aim to help achieve net zero targets, the OGA Strategy introduced new requirements on corporate governance, which are likely to impact oil and gas companies at board level, and enhanced the MER UK Strategy provision on collaboration and cooperation, which now becomes a Supporting Obligation rather than a Required Action or Behaviour.

Corporate Governance

As part of the new focus on the social licence to operate and with a view to preserving and enhancing the UKCS's reputation as a good place to do business, a new Supporting Obligation on Governance was introduced, requiring a relevant person to *'apply good and proper governance at all times, including complying with any principles and practices as the OGA may from time to time direct'*. The OGA has confirmed that it does not intend to duplicate existing corporate governance requirements and regimes but may, for example, make specific requirements where it considers those necessary. This may include requiring licensees to show that they have knowledge of the UKCS and the Strategy, and to consider the appointment of a non-executive director in the role of 'UKCS Champion'.

Collaboration

The OGA has long considered that commercial behaviours in the industry are a potential risk to achieving MER UK, for example where they delay progress or one party adopts an obstructive commercial position, and that has been a continued area of OGA focus. The MER UK Strategy included a Required Action and Behaviour that relevant persons *'consider whether'* collaboration would increase recovery of economically recoverable petroleum or otherwise affect compliance with any of its MER UK Strategy obligations. That requirement was supported by, for example, 'Stewardship Expectation 7 (Commercial Alignment and Delivery)', 'Stewardship Expectation 9 (Build a Culture of Collaboration)' and the OGA's 'Collaboration Toolkit'.

The OGA Strategy has enhanced the focus on collaboration by moving the requirement regarding collaboration to create a new Supporting Obligation on Collaboration. This now imposes an absolute obligation on relevant persons to collaborate and co-operate with other relevant persons, potential entrants to the industry and the supply chain when *'undertaking relevant activities'*. The OGA's response to its consultation on the draft strategy notes that this reflects the language at section 9A(1) of the Energy Act 2016, which sets the principal objective of achieving MER through (amongst other things) *'collaboration among'* relevant persons.

To further emphasise its view of the importance of collaboration, on 14 June 2021 the OGA published 'Stewardship Expectation 12' which focuses on the ways in which companies should collaborate with their supply chain contractors. That includes a focus on acting reasonably and fairly in all respects of the relationship, including prompt payment of invoices, regular updating on projects to the OGA's 'Pathfinder' system and efforts to work in a time and cost efficient way from tender stage throughout a project and adopt mutually beneficial remuneration models.

Challenges

The last twelve months have seen a number of attempts by environmental groups to bring challenges to regulatory decisions through court proceedings in many countries. The UK is no exception, and the OGA's exercise of its decision making powers is now beginning to be tested. Examples from the last year include:

— In October 2020, the Outer House refused permission to Greenpeace to bring a petition for judicial review against the Secretary of State for Business Energy and Industrial Strategy ('**BEIS**') and the OGA.[1] The petition sought to challenge the OGA's consent to an offshore field development project and BEIS' agreement to that consent. However, the petitioner also sought to challenge the decision by means of a statutory challenge to the grant of field development consent under the Offshore Petroleum Production and Pipe-lines (Assessment of Environmental Effects) Regulations 1999 (the '**1999 Regulations**'), by means of a procedure which provides a basis for an aggrieved party to apply to the court for an order quashing consent in respect of such a development project. Since there was a statutory route for such a challenge, the court determined that it was not appropriate to grant permission for judicial review proceedings

— The Scottish action followed on from judicial review proceedings in the High Court in England. In 2019, the founder of the Seahorse Trust challenged the issue of consent for the Colter appraisal well off the Dorset coast. The proceedings were settled by way of a consent order in connection with which the Secretary of State for BEIS accepted that the 1999 Regulations failed to properly transpose the EIA Directive into UK law. The government held a consultation in 2020 as part of a review of the 1999 Regulations and the implementation of the EIA Directive. The consultative response was published in December 2020 along with the Offshore Oil and Gas Exploration, Production, Unloading and Storage (Environmental Impact Assessment) Regulations 2020 which came into force on 31 December 2020.

1 *Petition of Greenpeace Ltd for Judicial Review* [2020] CSOH 88

— A member of the public living in North Yorkshire sought to challenge the OGA's decision to provide a letter of comfort which was a requirement to permit completion of the sale of a fracking company to a newly incorporated company.[2] A subsidiary of the fracking company held a licence to search and bore for petroleum and natural gas in the county of York. The claimant was concerned that following the sale, the buyer would not have the financial ability to meet its acquired licence commitments, which included proper decommissioning of gas wells, and instead taxpayers would have to meet the financial liabilities.

  The claimant was aware that in other countries fracking companies were becoming insolvent and taxpayers were picking up the costs for decommissioning and clean-up. As a result, in October 2019, the claimant sought permission to bring judicial review proceedings, based on an assertion that the OGA did not carry out an adequate financial assessment of the companies involved in the transaction, in particular, as to whether the risk that the sale could leave the taxpayer paying decommissioning and clean-up costs if the target company became insolvent.

  Permission to bring a judicial review application was refused. The Administrative Court considered that, taking account of the Petroleum Act 1998 and related regulations (and in particular, the Model Clauses that applied to the relevant licences), the OGA had properly considered the risks identified by the claimant. The Administrative Court concluded that the OGA had not failed to have regard to the need to minimise public expenditure as it had regard to this when making its decision to issue the letter of comfort.

2 *R (on the application of Thornton) v OGA* [2020] EWHC 2615 (Admin)

Licensing

On 3 September 2020, the OGA announced its offer for the award of 113 licences over 259 blocks or part-blocks to 65 companies. The round offered blocks in mature, producing areas, close to existing infrastructure. Upon its launch, significant volumes of 'ground-breaking' data, produced in collaboration with 11 companies including operators and third party specialists, were made available. This was collated by the OGA in an attempt to assist the industry in its efforts to stimulate exploration and promote the creation of new opportunities within the mature areas of the UKCS. Those awarded licences in the OGA's 32nd round included Equinor, BP, Chrysaor, Summit Exploration and Royal Dutch Shell.

Following the 32nd round, the OGA decided not to run a licence round in what would have been the 2020/21 period. The aim of this was to allow time for relinquishments, with a view to enabling more coherent areas to be reoffered in the future, as well as to give the industry time to deliver on work commitments in the existing portfolio of licences. The industry was encouraged by the OGA to use the pause to acquire data and carry out studies in preparation for the next round.

On the same day as the OGA's announcement, the UK Government announced a review of its policy on the future offshore oil and gas licensing regime in line with the 2050 'net zero' target. The result of that review formed part of the 'North Sea Transition Deal', a sector deal between the UK government, trade unions and the oil and gas industry to support the industry and its workers, businesses and supply chain to decarbonise North Sea production by harnessing the industry's existing capabilities, infrastructure and private investment potential to exploit new and emerging technologies such as hydrocarbon production, CCUS, offshore wind and decommissioning. While there is no firm deadline for the end of licensing on the UKCS, BEIS has announced that it will introduce a 'climate compatibility checkpoint' before each future licensing round to ensure license awards are aligned with wider climate objectives, including the 'net zero' target and the need for diversity of energy supply. It will use the latest evidence to assess domestic demand for oil and gas, projected production and the prevalence of clean technologies such as offshore wind and CCUS, and the sector's progress against greenhouse gas emissions reduction targets which it has voluntarily adopted (aiming to reduce emissions associated with offshore production of oil and gas on the UKCS by 50% by 2030 and 90% by 2040). If evidence suggests that a future licensing round would undermine the UK's climate goals or delivery of 'net zero', it will not go ahead.

Decommissioning

Costs targets

The OGA has a UKCS cost reduction target for decommissioning costs of 35% by the end of 2022 against the 2017 estimates (from around GBP 60bn to levels below GBP 39bn). It reports progress against that target annually and on 7 July 2021 published its latest update in its 'UKCS Decommissioning Cost Estimate' report for 2021. The report was prepared using cost estimates provided to the OGA by operators via its annual 'UKCS Stewardship Survey' and estimated that the total cost of UKCS offshore oil and gas decommissioning has fallen by 23% to GBP 46bn from the 2017 baseline of GBP 59.7bn. The report also found that the cost fell four percent on a like-for-like basis in

2020, largely due to the deferral of activity as a result of the COVID-19 pandemic, and the low commodity price. The report identified further opportunities for cost improvements, including the adoption of campaign and collaborative models and an increased sharing of data, lessons learned and good practice, and also potential risks to the required continued reduction, such as lack of collaboration, poor performance, delayed planning and cost inflation.

Decommissioning Strategy

The new 'OGA Decommissioning Strategy', published on 10 May 2021, updated the first version of the Decommissioning Strategy (which was published in 2016) to reflect lessons learned and the shift in focus of the new OGA Strategy. It aims to establish a clear framework to explain what is required of infrastructure owners in respect of decommissioning in order to comply with their obligations under the OGA Strategy and how the OGA will engage with them. The OGA's role in respect of decommissioning remains primarily in relation to cost considerations and the wider management of the basin's infrastructure; regulation of decommissioning remains the responsibility of OPRED, a division of BEIS, which approves decommissioning programmes, and additional provisions in respect of the plugging and abandonment of wells are set out in production licences.

The OGA considers that decommissioning presents real economic opportunities for the UK oil and gas industry to create a world-leading UK based industry in a way that supports 'net zero'. The priorities set out by the new OGA Decommissioning Strategy reiterate the focus of the OGA Strategy on delivery of cost-efficient decommissioning and on repurposing and reusing infrastructure in order to support CCS and hydrogen projects. There are four main aspects to the Decommissioning Strategy: planning for decommissioning; commercial transformation; supporting energy transition from late life into decommissioning; and technology, processes and guidance. It recognises that infrastructure owners may initially plan for re-purposing and decommissioning in parallel, to ensure that decommissioning can be executed promptly should re-purposing not prove viable.

Regulatory compliance

In October 2020, the OGA published its final report on its 'Thematic Review into Industry Compliance with Regulatory Obligations'. Although it recognised that the majority of licensees are complying with their obligations, it concluded that there are some who need to 'catch up'. The report highlighted that the areas in need of improvement are managing production, flaring and venting consents, and timeliness of licence extension requests. The report also set out longer term actions which the OGA expects from the industry, including considering new systems that could be implemented, particularly in relation to the energy transition.

The OGA has said that where there are breaches of regulatory obligations, it will be more proactive in the use of its powers going forward. That appears to be demonstrated by the announcement in February 2021 of the launch of a full investigation into a potential breach of reporting requirements under a licence, an increasing number of cases listed on the OGA's 'measured escalation process' chart, which recorded 15 Enquiries and eight Investigations as at June 2021, and two 2021 Investigations noted on its case register to June 2021.

Index of Cases

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