CHAPMAN TRIPP

LITIGATION & DISPUTE RESOLUTION

brief counsel

11 MARCH 2014

Top Australian Court finds wriggle room in "reasonable endeavours" test

A contractual obligation to use "reasonable endeavours" to supply gives the seller significant wriggle room, according to a recent decision in Australia's highest court[1] which we expect will be used as a precedent in this country.

Purchasers wanting an obligation to supply that is less than absolute but provides some certainty may be best advised to adopt alternative wording – "all reasonable endeavours" or "best endeavours", or clearly-defined required steps – and avoid giving suppliers the benefit of subjective performance criteria.

The context

The dispute concerned a long term gas supply agreement (*GSA*) between Electricity Generation Corporation, trading as Verve, and various gas suppliers in Western Australia.

The GSA required each supplier:

- to provide a proportionate share of a Maximum Daily Quantity (*MDQ*) of gas to Verve, and
- to use "reasonable endeavours" to supply a supplemental maximum daily quantity (*SMDQ*) but being able to take into account "all relevant commercial, economic and operational matters".

The litigation arose when an explosion at a gas plant reduced supply of natural gas to Western Australia by around a third, so that the market could no longer be fully supplied.

Verve was informed that it would not receive the nominated SMDQ during that time and would have to enter a competitive tender process under two short term supply contracts to receive any additional gas above MDQ (invariably at a higher price than in the GSA).

Verve entered these contracts "without prejudice" to its rights under the GSA. At issue was whether the suppliers had breached the "reasonable endeavours" obligation in the GSA and, depending on the answer to that question, whether Verve was entitled to restitution for economic duress.

The decision

The majority of the High Court of Australia (4:1), reversing the Western Australian Court of Appeal, found that the contract should be given a "business-like interpretation". Verve was not contractually bound to buy SMDQ from the Sellers and the Sellers were not contractually bound to reserve capacity in their plants in order to supply the SMDQ.

The majority concluded that the purpose of the wording, taken as a whole, was to provide for a balancing of interests of the parties in relation to SMDQ where those interests did not entirely coincide or conflict:

> *"What is a reasonable standard of endeavours … is conditioned both by the Sellers' express responsibilities to Verve in respect of SMQD and by the Sellers' express entitlement to take into account relevant commercial, economic and operational matters".*

Applied to the facts, the GSA did not oblige the suppliers to supply SMDQ to Verve when the gas plant explosion occasioned business conditions leading to conflict between the supplier's business interests (in obtaining the higher price on offer) and Verve's interest in obtaining nominated SMDQ at the GSA price.

Gageler J disagreed, saying that the majority's construction of the contract rendered the obligation to use reasonable endeavours "elusive, if not illusory" and meant that the price fixed by the GSA for SMDQ was "meaningful only if and when the Sellers consider it to their commercial advantage to accept it."

Chapman Tripp comments

The decision, although it may be able to be confined to the facts (in particular, by the express reference to the suppliers being able to take into account "commercial and economic" matters in determining whether to supply) is likely to become a leading case for suppliers wanting to weaken the obligation imposed by a "reasonable endeavours" clause.

To avoid the practical outcomes identified by Gageler J, purchasers wishing to give teeth to a less than absolute obligation to supply might consider alternative wording – such as "best endeavours" or "all reasonable endeavours" – and avoid the supplier having the benefit of subjective criteria to determine whether it performs or not.

These phrases have been held by the Courts, most recently by the Singapore Court of Appeal[2], to impose higher burdens on suppliers, including an obligation to act against their own commercial interests where the nature and terms of the contract indicate that this is an intended outcome.

Another approach would be to specify certain steps which have to be taken in order to satisfy the reasonable endeavours obligation, particularly if those steps may require one party to sacrifice its commercial interests.[3]

Footnotes

1. *Electricity Generation Corporation v Woodside Energy Ltd, Woodside Energy Ltd v Electricity Generation Corporation* [2014] HCA 7
2. *KS Energy Services Ltd v BR Energy (M) Sdn Bhd* [2014] SGCA 16, at [93]. The Court of Appeal's judgment contains an extensive summary of the interpretation of "best endeavours" and "all reasonable endeavours" clauses in the United Kingdom, Australia and Singapore.
3. See for instance, *Rhodia International Holdings Ltd v Huntsman International LLC* [2007] EWHC 292 (Comm).

JACK HODDER QC – PARTNER
T: +64 4 498 4944
E: jack.hodder@chapmantripp.com

DANIEL KALDERIMIS – PARTNER
T: +64 4 498 2409
M: +64 27 599 5839
E: daniel.kalderimis@chapmantripp.com

BRUCE MCCLINTOCK – PARTNER
T: +64 9 358 9819
M: +64 27 439 3112
E: bruce.mcclintock@chapmantripp.com

CATHERINE SOMERVILLE – PARTNER
T: +64 9 358 9813
M: +64 27 486 3309
E: catherine.somerville@chapmantripp.com

ANDREW WOODS – PARTNER
T: +64 3 353 0025
M: +64 27 436 0208
E: andrew.woods@chapmantripp.com

JO APPLEYARD – PARTNER
T: +64 3 353 0022
M: +64 27 444 7641
E: jo.appleyard@chapmantripp.com