Best endeavours in the supply of gas

David Parish reports on *Electricity Generation Corporation v Woodside Energy* [2014] HCA 7

Facts

In *Electricity Generation Corporation v Woodside Energy* the High Court grappled with an acronym bonanza and more definitions than have been seen since the time of Dr Johnson.

Verve Energy (the trading name of EGC) bought gas under a long-term gas supply agreement (GSA) from Woodside Energy and other gas suppliers (the sellers) to run its power stations.

Commercial gas supply is a complicated business. It frequently involves supplying a volatile and pressure based commodity to large industrial clients in fluctuating quantities from a complicated supply chain.[1] The GSA had a clause not unusual in gas supply agreements requiring the sellers to make available to Verve a maximum daily quantity of gas (an MDQ) and a optional top up amount should it be required, called a supplemental daily quantity of gas (SMDQ). Each contract year Verve was obliged to pay for an annual minimum quantity (AMQ) whether that minimum was used or not, what is colloquially known as a take or pay clause.

The mischief of the case was caused by an explosion at the Apache gas plant on Varanus Island which led to an interruption in supply and a corresponding surplus in demand.[2] To plug the supply shortage, the sellers sold their gas to Apache.[3] Over the period of the shortage the sellers were unable to supply SMDQ and Verve was required (under protest) to enter into expensive short term supply contracts with the sellers and other gas suppliers at the prevailing market price rather than the price set by the GSA.[4] In short, Verve alleged sellers abandoned their SMDQ obligations so they could take advantage of a spike in short term gas prices, forcing Verve to buy gas at inflated prices.

The best endeavours clause

If Verve required more gas than they received under the MDQ, the clause relating to the supply of SMDQ required the sellers to use reasonable endeavours to make the extra gas available for delivery (clause 3.3(a)) but that obligation did not require the sellers to provide extra gas where, taking into account all relevant commercial, economic and operational matters, the sellers formed the reasonable view there was insufficient capacity or time to meet the SMDQ (clause 3.3(b)).[5]

At the heart of the dispute was the interaction between these two sub-clauses.[6]

The crucial issue of construction was the relationship between the sellers' obligation in cl 3.3(a) to 'use reasonable endeavours' to make SMDQ available for delivery to Verve, and the sellers' entitlement under cl 3.3(b), in determining whether they 'are able to supply SMDQ' on any particular day, to 'take into account all relevant commercial, economic and operational matters'.

Verve argued that the sellers were obliged to use reasonable endeavours to make the SMDQ available and that clause 3.3(b) gave further content to that obligation to establish whether the sellers were able to supply the gas, not whether they wished to.[7] The sellers argued the reasonable endeavours clause could not be read in isolation and depended on the anterior questions arising under clause 3.3(b), such that the sellers were allowed to determine their ability to supply Verve based on all commercial, economic and operational matters available to them.[8] In other words, the sellers sought to use the commercial, economic and operational matters to subjectively read down the reasonable endeavours clause; Verve on the other hand sought to limit the operation of clause 3.3(b) to objective considerations.

The primary judge agreed with the sellers that clause 3.3(b) conditioned the best endevaours clause.[9] The Court of Appeal of the Supreme Court of Western Australia overturned that finding, accepting Verve's argument that clause 3.3(b) did not condition the reasonable endeavours clause but set out a set of factors to be taken into account[10] or to inform and delineate[11] the exercise of obligations under that clause.

The High Court accepted the interpretation put forward by the sellers, setting aside the decision of the Court of Appeal.

The majority[12]

In giving clause 3.3 a businesslike interpretation, the majority noted that the chief commercial purpose of the GSA was two-fold: it provided Verve with a certainty of supply up to the MDQ and it provided the sellers with an assured price in respect of the

ADQ. This insulated both parties from the risks of fluctuations in demand and price.[13]

The High Court noted that the supplementary nature of the SMDQ meant that Verve was not obliged to buy it and the sellers were not bound to reserve capacity in their plants for it.[14] Taken as a whole then, the majority held that cl 3.3 provided for a balancing of interests if the business interests of the parties did not coincide or if they conflicted.[15] The majority held that what is a 'reasonable' standard of endeavour is conditioned by both the sellers' obligations to Verve but also an express entitlement to take into account relevant commercial, economic and operational matters.[16] This meant that the sellers did not have to forego or sacrifice their business interests when using reasonable endeavours to make available SMDQ. Accordingly, Verve's argument that the use of the word 'able' to supply should restrict the considerations to capacity were rejected:

> The word 'able' in cl 3.3(b) relates to the sellers' ability, having regard to their capacity and their business interests, to supply SMDQ. This is the interpretation which should be given to cl 3.3.[17]

The minority

Gageler J's difficulty was that allowing the obligation of reasonable endeavours to be subject to the sellers' business interests rendered the clause 'elusive, if not illusory.'[18] The ability to sell gas at a higher price to someone else was not a factor relevant to whether 'they are able to supply SMDQ on the same day' in the words of clause 3.3.[19] Obtaining a higher price elsewhere does not make the sellers less able or have less capacity. 'They would remain 'able', just reluctant or unwilling.'[20]

Conclusion

It is uncertain whether the majority's definition of 'able' operates successfully outside the complicated world of commercial supply contracts. One could hardly avoid washing the dishes if one's inability proceeded from not coinciding with other interests. As a matter of ordinary usage in the words of Gageler J, one remains remain able, just reluctant or unwilling.

It may also be argued that the majority has elevated a businesslike interpretation over the plain words of the section that makes 'ability' its touchstone, not motivation.

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However, the case does illustrate the importance of the businesslike interpretation aid to the construction of commercial contracts. This begins with a precise identification of what in fact the commercial purpose and objects of that contract are. For legal advisers, this requires as objective an analysis as possible.

For some transactional lawyers, this case may prompt a rethink of reasonable or best endeavours clauses that preface the ability to meet the obligations with the promisor's other interests.

Endnotes

1. See for instance the *Gas Supply Chain in Eastern Australia* March 2008 by NERA Economic Consulting.
2. [2014] HCA 7 at [5].
3. [2014] HCA 7 at [5].
4. [2014] HCA 7 at [7] – [10].
5. [2014] HCA 7 at [17].
6. [2014] HCA 7 at [11].
7. [2014] HCA 7 at [24].
8. [2014] HCA 7 at [24].
9. [2014] HCA 7 at [24].
10. per Murphy JA cited at [2014] HCA 7 at [30].
11. per McLure P (Newnes JA agreeing) cited at [2014] HCA 7 at [31].
12. French CJ, Hayne, Crennan and Kiefel JJ.
13. [2014] HCA 7 at [45].
14. [2014] HCA 7 at [47].
15. [2014] HCA 7 at [45].
16. [2014] HCA 7 at [47].
17. [2014] HCA 7 at [47].
18. [2014] HCA 7 at [60].
19. [2014] HCA 7 at [66].
20. [2014] HCA 7 at [66].