

Liability

A formula is specified in the Deed for calculation of the payment due from IPRH to the State for a breach of the Cap.

For each tonne of greenhouse gas emitted from the Hazelwood Power Station in excess of the Cap, IPRH must pay the State the lesser of \$10 (subject to the percentage increase in CPI, calculated relative to the December 2004 quarter) and the marginal dollar cost of abatement of one tonne of greenhouse gas from electricity generation in the national electricity market as at the date the extra tonne of greenhouse gas is emitted in excess of the Cap.

This amount is a cap on IPRH's liability for a breach of the Cap. In respect of all breaches of the Deed (other than a breach of the Cap), IPRH's liability is capped at \$2,000,000 (subject to the percentage increase in CPI, calculated relative to the December 2004 quarter). The limitation of IPRH's liability to damages does not affect the right of the State to any other remedy for a breach by IPRH of the Deed.

The State acknowledges that any claim shall be made against IPRH, and not International Power Australian or any other related entity.

Conclusion

While the Deed has been attacked by environmental groups, it has been regarded by business as a positive step in securing Victoria's ongoing supply arrangements. It will remain to be seen whether the approach set out in the Deed of capping greenhouse gas emissions over the life of the Power Station is practical and effective. It will also be interesting to observe whether the approach is suited only to Victoria's unique circumstances (in that Victoria is highly dependent for its power supply on the use of brown coal) or whether the "greenhouse cap" model could have application in other States and Territories of Australia.

IMPLYING THE DUTY OF GOOD FAITH INTO ASSIGNMENT CLAUSES IN JOINT VENTURE AGREEMENTS*

Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL (recs and mgrs apptd) (admins apptd) [2005] VSCA 228, Warren CJ, Buchanan JA and Osborn AJA, 15 September 2005

Joint venture agreement – insolvency of a party – assignment of the its interest – construction of assignment clause – whether a duty of good faith is implied – whether the party had acted in good faith.

Facts and nature of the action

Esso Australia Resources Pty Ltd ("Esso"), Southern Pacific Petroleum ("SPP") and Central Pacific Minerals (CPM) formed a joint venture to exploit mineral tenements and produce shale oil

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near Gladstone in Queensland. The joint venture, known as the "Rundle Joint Venture", was governed by a joint venture agreement dated 15 March 1985 ("Joint Venture Agreement"). Esso held a 50 per cent interest in the Rundle Joint Venture, while SPP and CPM each held a 25 per cent interest. After oil prices fell in the late 1980's, Esso withdrew from the shale oil industry in the United States and, in accordance with the terms of the Joint Venture Agreement, deferred the Rundle shale oil project.

In March 2002, SPP and CPM merged, resulting in CPM becoming a subsidiary of SPP. By late 2003, both SPP and CPM were experiencing solvency problems, which led to the appointment of receivers and managers under charges in respect of the secured assets of the companies. The Rundle Joint Venture interests of SPP and CPM were not secured by the charges and accordingly were not subject to the receivership and management arrangements and the subsequent sale of the secured assets. In February and March 2004, SPP and CPM entered into voluntary administration and administrators were subsequently appointed. The administrators sought to sell SPP and CPM's interests in the Rundle Joint Venture.

Under the Joint Venture Agreement, Esso's consent was required for any assignment of SPP or CPM's joint venture interest, unless the assignment was to a "related corporation" (defined by reference to the *Companies Act 1981* (Cth)). Esso expressly stated that it would not waive its right to give consent to any assignment proposed by the administrators. Although not an issue considered in detail by the trial judge, it is noted that in addition to its right to consent to the assignment of an interest under the Joint Venture Agreement, Esso also held pre-emptive rights in respect of any sale of SPP and CPM's joint venture interests.

The creditors of SPP and CPM approved two draft deeds of company arrangement providing for effective disposal of the companies' joint venture interests. These draft deeds of company arrangement were structured in such a way as to obviate the requirement for Esso's consent. Under the SPP draft deed of company arrangement, SPP would assign its interest in the Rundle Joint Venture to a new company, "SPV". SPP would appoint the directors of SPV, meaning that SPP had control over the board of SPV. This would make SPV a "related corporation" of SPP for the purposes of the *Companies Act 1981* (Cth) and therefore, in accordance with the assignment provisions of the Joint Venture Agreement, Esso's consent to the assignment of joint venture interests would not be required. In addition, the draft deed of company arrangement provided that SPV would assume SPP's obligations under the Joint Venture Agreement, SPP would guarantee the performance of those obligations by SPV as required by the assignment provisions of the Joint Venture Agreement, and that SPP would be liquidated once the assignment to SPV had been finalised.

Esso sought to restrain the assignment of SPP's joint venture interest pursuant to the draft deed of company arrangement. The primary issue at trial was whether the assignment had breached the Joint Venture Agreement. The trial judge rejected this argument, finding that the terms of the Joint Venture Agreement had been complied with.

Esso also argued that the assignment breached a general provision of the Joint Venture Agreement which prohibited a party from acting in a manner giving rise to conditions prejudicial to, or in conflict with, the best interests of the other party. The trial judge held that this conflict of interest provision had not been breached, because the provision was stated to be being "subject to this agreement", and accordingly could not be breached by a valid assignment pursuant to the terms of the Joint Venture Agreement.

On appeal, Esso argued that the assignment constituted a breach of an implied obligation of good faith in the Joint Venture Agreement. Esso also asserted that the liquidation of SPP following finalisation of the assignment to SPV meant that SPP would not, and arguably had never intended to, guarantee the obligations of SPV going forward. Esso contended that the purpose of the assignment provision was to ensure the continued presence of an original participant, albeit through a related entity, and that the liquidation of SPP breached an implicit obligation of good faith.

Decision and Reasoning

As already noted, the trial judge found that SPP and CPM's conduct and the proposed arrangements resulting from the draft deed of company arrangement did not breach the assignment provisions of the Joint Venture Agreement.

The Court of Appeal held that it was not necessary to determine whether a term requiring the exercise of good faith should be implied in the Joint Venture Agreement as, even if such an obligation was to be imposed, it had not been breached. The test for whether an implied duty of good faith had been breached required evidence of unreasonableness, a capricious act, attempting to further an ulterior purpose or seeking to prevent the performance of the contract or deprive the other party of a benefit.

Applying these tests, the Court of Appeal held that the substance of the proposed transaction was to actually replace a "moribund joint venturer" with a partner that was able to contribute funds to the advance of the Rundle Joint Venture. Esso had not been deprived of anything of value, whilst the creditors of SPP would receive a material benefit. If SPP was not wound up as proposed, its creditors would have been subordinated to what was merely a "shadow of a benefit" that Esso would otherwise receive. The Court of Appeal stated that the duty of good faith requires that due regard be given to the interests of both parties and the benefits afforded by the contract, not just the interests of the other party.

Relevance of Decision

The decision indicates the Court of Appeal's reluctance to imply good faith in the commercial context. The Court of Appeal stated that as good faith interferes with the important requirement of certainty in contractual activity, it should not be applied indiscriminately to all rights and powers granted in a commercial contract. However, the Court of Appeal noted that good faith will play a role in contractual dealings where a vulnerable party requires protection from exploitive conduct which subverts the original purpose for which the contract was made. However, in the context of commercially mature parties, if a party is more shrewd, cunning and out-manoeuvres the other party, then that latter party will not be afforded greater protection than that provided by the law of contract.

The decision also reminds practitioners that caution must be exercised in drafting assignment clauses, as they may be read strictly and literally to the potential detriment of a party who wishes to retain some form of control over the identity of the participants in joint ventures to which it is a party.