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Decision of the High Court of Australia of Interest to Canada's Energy Bar

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Decision commented on: *Electricity Generation Corporation v Woodside Energy Ltd*, [2014] HCA 7

In this majority decision the High Court of Australia (HCA) concluded that the obligations of a seller under a gas purchase agreement (GSA) to use "reasonable endeavours" to provide the purchaser with a supplemental maximum daily quantity of gas (SMDQ) in addition to an agreed maximum daily quantity of gas (MDQ) did not require the seller to provide any gas at the SMDQ price when market opportunities emerged which afforded the seller the opportunity to sell all its available production beyond MDQ at a much higher price. While any case such as this turns on the particular language of the GSA in question, including the surrounding circumstances known to the parties and the commercial purpose or objects to be secured by the agreement, the case serves as a reminder that terms such as "best efforts" or "reasonable endeavours", at least when viewed in the self-seeking paradigm of contract, may not offer much comfort to the counterparty in this sort of commercial arrangement.

Rather than providing a detailed description of the facts of this case this post seeks to highlight the key contractual provisions in the agreement that convinced the majority to rule in favour of the seller. The most significant provisions in the GSA were the SMDQ clauses which provided as follows (at para 17):

> **3.3 Supplemental Maximum Daily Quantity**
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> (a) If in accordance with Clause 9 ('Nominations') the Buyer's nomination for a Day exceeds the MDQ, the Sellers *must use reasonable endeavours* to make available for delivery up to an additional 30TJ/Day of Gas in excess of MDQ …
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> (b) In determining whether they *are able to supply SMDQ on a Day, the Sellers may take into account all relevant commercial, economic and operational matters* and, without limiting those matters, it is acknowledged and agreed by the Buyer that nothing in paragraph (a) requires the Sellers to make available for delivery any quantity by which a nomination for a Day exceeds MDQ where any of the following circumstances exist in relation to that quantity:
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> (i) the Sellers form the reasonable view that there is insufficient capacity available throughout the Sellers' Facilities (having regard to all existing and likely commitments of

each Seller and each Seller's obligations regarding maintenance, replacement, safety and integrity of the Sellers' Facilities) to make that quantity available for delivery;

(ii) the Sellers form the reasonable view that there has been insufficient notice of the requirement for that quantity to undertake all necessary procedures to ensure that capacity is available throughout the Sellers' Facilities to make that quantity available for delivery; or

(iii) where the Sellers have any obligation to make available for delivery quantities of Natural Gas to other customers, which obligations may conflict with the scheduling of delivery of that quantity to the Buyer.

(c) The Sellers have no obligation to supply and deliver Gas on a Day in excess of their obligations set out in Clauses 3.2 and 3.3 in respect of MDQ and SMDQ respectively.

(Emphasis supplied by the Court).

What was convincing for the majority was the italicized language which emphasised that a seller's "ability" to supply must be assessed not only in terms of its physical ability to deliver, but also in terms of "relevant commercial, economic and operational matters". Seen within the self-seeking frame of reference of contract rather than the fiduciary's duty of undivided loyalty (the GSA expressly denounced any intention to impose a fiduciary obligation on any party, see note 56 in the decision), the Court did not hesitate long before concluding (at para. 47) that the seller was entitled to take into account its own commercial interests in deciding whether it had SMDQ gas to deliver at SMDQ prices (which were considerably lower than the spot price):

> What is a "reasonable" standard of endeavours obliged by cl 3.3(a) is conditioned both by the Sellers' responsibilities to Verve in respect of SMDQ and by the Sellers' express entitlement to take into account "relevant commercial, economic and operational matters" when determining whether they are "able" to supply SMDQ. Compendiously, the expression "commercial, economic and operational matters" refers to matters affecting the Sellers' business interests. The relevant ability to supply is thus qualified, in part, by reference to the constraints imposed by commercial and economic considerations. The non-exhaustive examples of circumstances in which the Sellers will not breach the obligation to use reasonable endeavours to supply SMDQ, found in cl 3.3(b)(i), (ii) and (iii), are not confined to "capacity" (or capacity constraints). The effect of cl 3.3(b) is that the Sellers are not obliged to forgo or sacrifice their business interests when using reasonable endeavours to make SMDQ available for delivery. Verve's submission that "able" should be construed narrowly, so as to refer only to the Sellers' capacity to supply, fails to give full effect to the entire text of cl 3.3(b) and must be 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.

Two other extracts from the judgement are also worth quoting *in extenso*. The first passage (para. 35) is worth quoting because it encapsulates the HCA's approach to interpreting commercial contracts and in particularly succinct manner (and it will be recalled that an earlier HCA judgement, *Hospital Products Ltd v. United States Surgical Corporation*, 1984 HCA 64 had previously emerged as a significant authority in the common law world on the interpretation of contracts). This passage (references omitted) reads as follows:

> Both Verve and the Sellers recognised that this Court has reaffirmed the objective approach to be adopted in determining the rights and liabilities of parties to a contract. The meaning of the terms of a commercial contract is to be determined by what a reasonable businessperson would have understood those terms to mean. That approach is not unfamiliar. As reaffirmed, it will require consideration of the language used by the parties, the surrounding circumstances known to them and the commercial purpose or objects to be secured by the contract. Appreciation of the commercial purpose or objects is facilitated by an understanding "of the genesis of the transaction, the background, the context [and] the market in which the parties are operating". As Arden LJ observed in *Re Golden Key Ltd*, unless a contrary intention is indicated, a court is entitled to approach the task of giving a commercial contract a businesslike interpretation on the assumption "that the parties ... intended to produce a commercial result". A commercial contract is to be construed so as to avoid it "making commercial nonsense or working commercial inconvenience".

The second passage (paras 40 – 43, references omitted) is useful because it provides us with the Court's general views on contractual clauses like "best efforts and "reasonable endeavours":

> 40. Contractual obligations framed in terms of "reasonable endeavours" or "best endeavours (or efforts)" are familiar. Argument proceeded on the basis that substantially similar obligations are imposed by either expression. Such obligations are not uncommon in distribution agreements, intellectual property licences, mining and resources agreements and planning and construction contracts. Such clauses are ordinarily inserted into commercial contracts between parties at arm's length who have their own independent business interests.
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> 41. Three general observations can be made about obligations to use reasonable endeavours to achieve a contractual object. First, an obligation expressed thus is not an absolute or unconditional obligation. Second, the nature and extent of an obligation imposed in such terms is necessarily conditioned by what is reasonable in the circumstances, which can include circumstances that may affect an obligee's business. This was explained by Mason J in *Hospital Products Ltd v United States Surgical Corporation* which concerned a sole distributor's obligation to use "best efforts" to promote the sale of a manufacturer's products. His Honour said:
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> > "The qualification [of reasonableness] itself is aimed at situations in which there would be a conflict between the obligation to use best efforts and the independent business interests of the distributor and has the object of resolving those conflicts by the standard of reasonableness ... It therefore involves a recognition that the interests of [the manufacturer] could not be paramount in every case and that in some cases the interests of the distributor would prevail."
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> 42. As Sellers J observed of a corporate obligee in *Terrell v Mabie Todd & Co Ltd*, an obligation to use reasonable endeavours would not oblige the achievement of a contractual object "to the certain ruin of the Company or to the utter disregard of the

interests of the shareholders". An obligee's freedom to act in its own business interests, in matters to which the agreement relates, is not necessarily foreclosed, or to be sacrificed, by an obligation to use reasonable endeavours to achieve a contractual object.

43. Third, some contracts containing an obligation to use or make reasonable endeavours to achieve a contractual object contain their own internal standard of what is reasonable, by some express reference relevant to the business interests of an obligee.

My final comment is that it is useful for the Canadian energy bar to see a senior appellate judgement on such an important matter as this precisely because I doubt very much that we can expect to get this sort of guidance from a Canadian court if only because of the penchant of the energy industry in Canada to opt for confidential arbitration rather than open court litigation in such matters. This is a source of disappointment for academics but it also deprives the courts of the ability to develop a transparent jurisprudence to guide the drafting of important commercial agreements. Each such arbitral award is but a single instance with no normative authority beyond the specific dispute and the particular parties to the dispute.