DLA PIPER

EXCLUSIVE REMEDY CLAUSES:

A CAUTIONARY TALE

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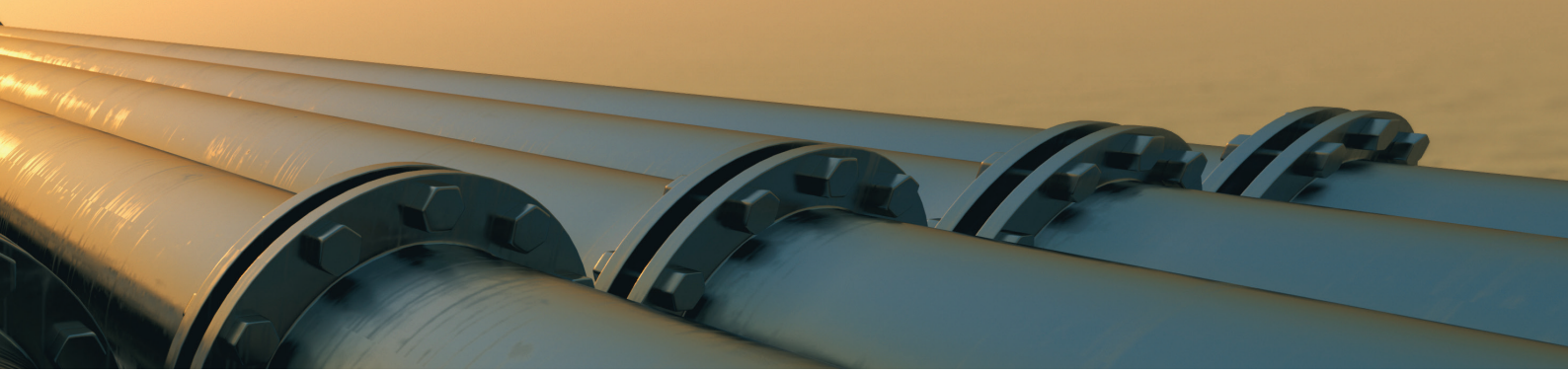

INTRODUCTION

Oil and gas suppliers, faced with difficult market conditions, will look to take full advantage of the contractual machinery at their disposal to limit their liability to contractual counterparties. A prime example of that is suppliers seeking to rely on exemption or exclusive remedy clauses to exclude certain obligations or to exclude or limit the heads and quantum of damages that they may have to pay, should a breach occur.

This article provides a brief overview of exemption and exclusive remedy clauses (as a matter of English law), and summarises the issues arising from the recent case of *Scottish Power UK PLC v BP Exploration Operating Company Ltd and Others* [2016] EWCA Civ 1043 ("**Scottish Power v BP Exploration**"), in which the liability of suppliers of gas was limited to a pre-agreed contractual remedy in circumstances wider than the buyer had anticipated.

Although this article focuses on the English law position, the perspectives offered are of interest in a broader international context. It may also provide useful insight for those involved in the negotiation and drafting of long term sale and purchase agreements.

EXEMPTION AND EXCLUSIVE REMEDY CLAUSES

There are various different types of exemption clause, which encompass exclusion and limitation clauses, *viz*:

(1) those excluding a party's substantive obligations (for example, excluding implied terms or liability for anything but wilful neglect or default);

(2) those excluding or limiting a party's liability for breach (e.g. excluding liability to be sued for breach or to be liable in damages, or limiting the remedies available to the other party); and

(3) those excluding or limiting a party's obligation to compensate fully the other (e.g. limiting the amount of recoverable damages or the time within which a claim must be made).[1]

Generally, a party wishing to rely on an exemption clause must show (a) that the clause has been incorporated into the contract, either by signature or by giving the other party sufficient notice of the clause; (b) that, on its true construction, the clause covers the breach and loss that have occurred;[2] and (c) that it is not subject to any statutory limitations (including, for example, that it is unenforceable by reference to the Unfair Contract Terms Act 1977).

There is a distinction between pure exclusion and limitation clauses and exclusive remedy clauses which replace common law remedies with contractually prescribed remedies in the event of a breach of contract. The relative benefit of contractual exclusive remedy clauses is materially affected by prevailing market conditions; it may be that the remedy available under such a clause may be more valuable than what could be recovered in an ordinary claim for damages to put the innocent party back in the position it would have been in had the contract been properly performed. It is partly for that reason that these clauses are hot topics.

[1] See *Chitty on Contracts*, 15-003.

[2] Treitel, *The Law of Contract*, 7-003.

SCOTTISH POWER V BP EXPLORATION

In Scottish Power v BP Exploration, the Court of Appeal ruled on the interpretation of an exclusive remedy clause in a large scale gas sale and purchase agreement. The remedy for the buyer in the event of an underdelivery of gas by the seller set out in the contract was held to be the buyer's only recourse against the seller when underdelivery occurred, to the exclusion of the seller's right to claim damages to put it into the position it would have been in had the contract been properly performed in the usual way.

Factual Background

In 1994 Scottish Power UK PLC ("**Scottish Power**") entered into a series of agreements for the purchase of natural gas (the "**Agreements**") from the respondents, BP Exploration Operating Company Ltd ("**BP**") and three others (together, the "**Sellers**"). The gas was to come from the Andrew Field, an oil and gas reservoir in the North Sea owned primarily by BP. Under the Agreements, Scottish Power was entitled to make daily nominations of the quantity of gas they required. If the sellers failed to provide the quantity of gas nominated by Scottish Power, Scottish Power become entitled to "Default Gas" at a discounted rate with respect to the difference in quantity between the volume of gas nominated and the volume of gas delivered.

In May 2011 the Sellers shut down production from the Andrew Field. Scottish Power continued to make daily nominations of the gas they required, in accordance with the Agreements. However, for various reasons including a pipe work leak, the shut-in lasted far longer than expected and no gas was delivered to Scottish Power for more than three years.

Scottish Power brought proceedings in which it sought to recover damages in the amount of the difference between what it would have paid for gas under the Agreements and what it in fact paid to acquire gas from alternative sources as a result of the underdelivery. In the ordinary way (at least as a matter of English law) Scottish Power was seeking a remedy which would put it back into the position it would have been in had the contract been properly performed (i.e. had it been supplied with gas under the Agreements).

First Instance Decision

At first instance,[3] the court found that the Sellers had breached the Agreements by failing to supply gas. The decision to shut-in the Andrew Field fell below the "Standard of a Reasonable and Prudent Operator" required by the Agreements.[4]

The court held that an exclusion clause in the Agreements which excluded liability for "*loss of use, profits, contracts, production or revenue*" was not engaged in the circumstances because Scottish Power's claim was merely for the loss which arose from the need to buy alternative supplies of natural gas in the open market to replace the gas which the Sellers should have provided under the Agreements, not the specified types of loss excluded by the clause.[5]

However, the court also held that Scottish Power's remedies for breach were limited, by Article 16 of the Agreements, to the contractual remedy of "Default Gas"[6] and that they could not claim what Scottish Power regarded as their actual loss (which was greater than the sum which they were entitled to recover under the contract).

Scottish Power appealed the decision, which left them significantly out of pocket as a result of BP's breach of contract.

Court of Appeal Decision

The Court of Appeal upheld the first instance decision and dismissed the appeal, deciding that the provisions regarding Default Gas amounted to a comprehensive contractual remedial regime that applied to the breach in question, and found that the provision operated so as to exclude any other remedy for an underdelivery of gas.

In reaching its decision, the Court of Appeal considered the extent to which the English law presumption[7] that parties do not intend to give up rights or claims which the general law gives them. However, the Court held that "*the strength of the presumption is reduced in proportion to the degree of derogation from the common law position* [i.e. that a party can recover damages for breach of contract which put it back in the position it would have been in had the contract been properly performed]".[8]

Since the Default Gas provision only operated to replace Scottish Power's remedy rather than excluding liability entirely, the extent of what Scottish Power had agreed to give up was relatively slight (at least as a matter of principle). On that basis the decision at first instance was upheld, with the contractual remedy being the sole and exclusive remedy available to Scottish Power.

[3] [2015] EWHC 2658 (Comm).
[4] [2015] EWHC 2658 (Comm), paras 112, and 117-120.
[5] [2015] EWHC 2658 (Comm), para 179.
[6] [2015] EWHC 2658 (Comm), paras 173-5.
[7] See *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd* [1974] AC 689.
[8] [2016] EWCA Civ 1043, para 30.

CONCLUSION

In light of *Scottish Power v BP Exploration*, a number of practical considerations arise for anyone involved in the drafting, negotiation or operation of contracts containing exclusive remedy clauses.

1. Clauses which provide for an exclusive remedy (as opposed to those which seek to exclude liability for a particular form of loss altogether), are likely to be enforceable as a matter of English law. That will be the case even where that leaves the innocent party out of pocket.

   On its face that is an iniquitous result. However, it reflects the approach of English law that where possible the court should look to uphold the intention of the parties when entering into the agreement. It may well have been the case that when this contract was entered into the contractual remedy was of greater value to the buyer than the damages it would otherwise have been able to claim. That subsequent changes in market conditions mean that is no longer the case would not appear to be a relevant consideration (at least on these facts).

2. Definition of scope is, as ever, of fundamental importance. Unless the scope of the contractual remedy clause is clearly defined, it may be found to operate in respect of a broader category of breach than one of the parties anticipated. Where the market has turned, that could have catastrophic consequences for a party which needs a "full" remedy which is not limited by a contractual remedy provision in respect of a particular breach.

3. More generally, the case also demonstrates the English courts' approach to the interpretation of contracts, focusing on the intention of the parties as reflected in the ordinary meaning of the words used. Both courts accepted that there was ambiguity in the wording of the Agreements as to the range of circumstances in which the Default Gas provision would apply. However, the Court of Appeal found that the interpretation proposed by Scottish Power involved "*a degree of legal finesse which commercial men are unlikely to have contemplated*".[9]

   The lesson for us all in that is that we must draft in a way which is precise, clear and which recognises that the intention of the commercial teams (rather than their legal teams and external lawyers), viewed objectively, is to the fore on questions of interpretation.

[9] [2016] EWCA Civ 1043, para 22.

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