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LITIGATION UPDATE:

HIGH COURT UPDATES "REASONABLE ENDEAVOURS": *COMMERCIAL INTERESTS VS AN OBLIGATION OWED*

Electricity Generation Corporation v Woodside Energy Ltd; Woodside Energy Ltd v Electricity Generation Corporation [2014] HCA 7 (5 March 2014)

WHAT HAPPENED?

- The High Court has, by a 4:1 majority, held that Woodside Energy Ltd and other gas suppliers in Western Australia (the Sellers) did not breach their obligation under a Gas Supply Agreement to use "reasonable endeavours" to make additional quantities of gas available to the Electricity Generation Corporation t/as Verve Energy (Verve).
- The Court has reaffirmed its approach to the interpretation of commercial contracts that such contracts should be given a business-like interpretation on the assumption that parties intended to produce a commercial result.
- Viewed in this light, contractual obligations framed in terms of "reasonable endeavours" do not oblige a party to forego or sacrifice their business interests.

THE BACKGROUND

The Sellers and Verve were parties to a Gas Sale Agreement (GSA), which in addition to the maximum daily quantity of gas, also obliged the Sellers to use "reasonable endeavours" to make available to Verve a supplemental maximum daily quantity of gas (SMDQ).

On 3 June 2008, an explosion occurred at a gas plant operated by a third party (Apache Energy Limited). This led to a shortfall of gas supply in the West Australian market. The Sellers subsequently offered to supply Verve with an equivalent quantity of gas at the higher market price rather than the price usually given under SMDQ. Verve accepted the price, but under protest and commenced legal proceedings in March 2009.

The High Court's Decision

The crux of the dispute between the parties concerned the Sellers' obligation in cl 3.3(a) of the GSA to "use reasonable endeavours" to make SMDQ available for delivery to Verve, as well as the Sellers' entitlement under cl 3.3(b) to "take into account all relevant commercial economic and operational matters".

Overturning the decision of the Court of Appeal, the majority held that reading the "reasonable endeavours" clause as a whole, in determining whether the Sellers were "able" to supply SMDQ, the Sellers could take into account "all relevant commercial, economic and operational matters." In reaching this conclusion, the High Court held that the GSA, being pre-eminently a commercial contract between parties at arm's length with their own independent business interests, should be given a business-like interpretation.

Interpretation of "reasonable endeavours"

The Court noted three general points on interpreting reasonable endeavour clauses:

1. An obligation to use reasonable endeavours is not an absolute or unconditional obligation;
2. The nature and extent of the obligation imposed is necessarily conditioned by what is reasonable in the circumstances, which can include circumstances that may affect an obligee's business; and
3. Some contracts which have a reasonable endeavours term also contain their own internal standard of what is reasonable through an express reference relevant to the business interests of an obligee (see *CPC Group Ltd v Qatari Diar Real Estate Investment Company* [2010] EWHC 1535 (Ch) at [252]).

IMPLICATIONS FOR YOU

Whether the High Court's decision can be viewed as a "game-changer" when interpreting "reasonable endeavours" clauses going forward, is debateable.

The Court affirmed its prior judgments in relation to how these clauses are construed, with special emphasis being placed on the Court's prior judgments concerning an obligee's freedom to act in its own business interests. For instance, the majority judgment referred to Hospital Products (see *Hospital Products Ltd v United States Surgical Corporation* [1984] HCA 64; (1984) 156 CLR 41) where it was held that the interests of the opposing party "could not be paramount in every case" and Terrell (see *Terrell v Mabie Todd & Co Ltd* (1952) 69 RPC 234) where it was held that reasonable endeavours would not require the achievement of a contractual object to the "certain ruin of the company or [with] utter disregard of the interests of the shareholders." In the case at hand, the current High Court used the words that reasonable endeavours should be "conditioned" by what is "reasonable in the circumstances…which can include circumstances that may affect an obligee's business."

However, whether this new reminder from the Court that reasonable endeavours must be conditioned by reference to what is reasonable in the circumstances imports a wider view, is to be seen. The Court's discussion that some contracts may import a subjective standard of what is reasonable in the context of reasonable endeavours, certainly lends weight to this argument. What is clear though, is that reasonable endeavours is not unconditional nor an absolute term that requires a party to disregard its own commercial interests.

There will likely be continued tension in regards to when a party's own commercial interests 'trump' that of their obligation to use reasonable endeavours for the benefit of the other party.

Accordingly, it is advisable that in any contract, for provision of services/ goods in any industry, the parties specify what reasonable endeavours (or a variation thereof) means in the context of the obligation owed.

MORE INFORMATION

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