Oil and Gas

June 2017

ARE YOU ENTITLED TO PAYMENT UNDER YOUR CONTRACT:

HAVE YOU DOTTED YOUR 'I'S AND CROSSED YOUR 'T'S?

The general principles of contractual interpretation are easy to state, but the application of such principles appears to be deceivingly simple, given the recent string of differing English decisions that demonstrated the various judicial approaches to contractual interpretation.

The current troubled state of the oil and gas industry creates a fertile landscape for payment disputes to arise. Some disputes arise because parties are not following, to the letter, contractual steps which are likely to be pre-conditions for payment.

The decision in *Gard Shipping AS v Clearlake Shipping Pte Ltd*[1] gives a flavour of the current approach adopted by the English Court on contractual interpretation. However, before discussing the decision, it is perhaps useful to understand the judicial developments on contractual interpretation in recent years:

- In *Rainy Sky SA and others v Kookmin Bank*[2] *(Rainy Sky)*, the Supreme Court preferred the interpretation which was consistent with the commercial purpose of the refund guarantees in relation to shipbuilding contracts.
- In the subsequent case of *Arnold v Britton & others*[3] *(Arnold v Britton)*, the Supreme Court however cautioned that while reliance must be placed on commercial common sense, this should not undermine the importance of the language of the provision. The Supreme Court therefore preferred a literal interpretation of a service charge clause in a lease despite its harsh effect on individual tenants.
- The next case before the Supreme Court on contractual interpretation was *Wood v Capita Insurance Services Limited*[4] (Wood v Capita). The Supreme Court stressed that there was no inconsistency in the judicial approaches in *Rainy Sky and Arnold v Britton*,

1 [2017] EWHC 1091
2 [2011] 1 WLR 2900
3 [2015] UKSC 36
4 [2017] UKSC 24

Various offshore, oil and gas contracts often require notices to trigger the entitlement to payment. So you cannot assume your entitlement for payment unless you have properly triggered the contractually required steps. In this market, these points will be taken to avoid payment.

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highlighting that textualism and contextualism are not conflicting or exclusive approaches in the field of contractual interpretation.

This decision of *Gard Shipping AS v Clearlake Shipping Pte Ltd* issued on 12 May 2017 is significant because it is the High Court's first application of the Supreme Court's decision in *Wood v Capita* on contractual interpretation.

Key background facts

The claimant owner entered into a charter party with the defendant charterer on the hire of a vessel for one voyage, which was varied by an addendum providing for a second voyage in continuation of the first.

The relevant salient terms of the charter party provided that the charterers had the liberty to instruct the vessel to stop and wait for orders for a maximum of three days at a safe place. Upon the expiration of five days following the issuance of the order, demurrage at an escalated rate will be payable to the claimant.

The vessel arrived at Rotterdam at 2230 on 26 January 2016 and the Notice of Readiness was tendered at 2250 on the same day. The defendant did not give discharge instructions until 31 March 2016. The vessel waited at Rotterdam for 64.7083 days.

The issue for the court's determination was whether the claimant was entitled to claim demurrage at an escalated rate over 64.7083 days during which the vessel was waiting to discharge cargo at Rotterdam. The claimant claimed the sum of $976,731.79 on their interpretation of the charter terms or alternatively, an implied term that would allow them to claim demurrage at the escalated rate.

Construction of contractual provisions

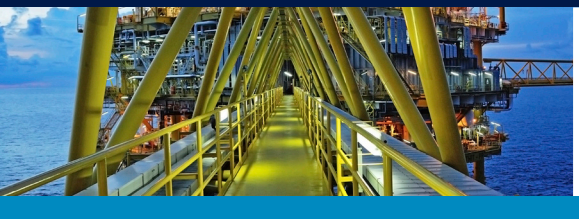
The claimant contended that the terms of the charter party meant that the defendant was not allowed to instruct the vessel to stop and wait for orders for more than three days, was not entitled to use the vessel as floating storage and that the vessel was to be considered as being used for floating storage if stopped for more than five days over the course of the voyage, whether before or after tendering Notice of Readiness. If the vessel was to be used for floating storage, then the defendant would be obliged to pay demurrage at the escalated rates.

The claimant further contended it was clear that the commercial purpose of the charter party was to make charterers liable for demurrage at escalating rates where they used the vessel as floating storage. It did not make commercial sense if the defendant could avoid demurrage at escalating rates by giving no stop and wait order as indicated in the charterparty.

The English High Court however rejected the claimant's argument and adopted a literal interpretation of the charterparty. Sir Jeremy Cooke held that the contract clearly provides that escalating demurrage rates only applied where there is a stop and wait order given to the vessel and this must be given effect to. Accordingly, the ordinary demurrage rate applied.

Claimant's argument on implied term for business necessity

The claimant made an alternative argument on the implication of term of the same effect as to the proper construction of the charter party regarding the application of escalating demurrage rates. The claimant argued that it would not be commercially coherent for parties to have agreed a regime to compensate owners for a delay caused by charterers ordering the vessel to wait for orders, if the



charterers could escape that regime by tendering Notice of Readiness.

The claimant's arguments on the implication of term was rejected by the Court on the grounds that:

- There was no commercial necessity for the implication of such term.
- The implication of the term was inconsistent with the charter party properly construed.

Comment

The court's reasoning shows that arguments along the lines that it must be 'obvious' how the contract was meant to work, will not always work. Various offshore, oil and gas contracts often require notices to trigger the entitlement to payment. So you cannot assume your entitlement for payment unless you have properly triggered the contractually required steps. In this market, these points will be taken to avoid payment. It is important to seek legal advice at an early stage of a dispute to properly assess how the key contract payment terms are likely to be assessed by a judge or an arbitrator and strategise accordingly.

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