International Commerce

October 2013

Welcome to the latest edition of our regular India Bulletin

Our first article considers the dash for gas from an Indian perspective, looking at the risks and benefits of FLNG. Our second article then continues the focus on energy, looking at the coal trade and highlighting India's increasing reliance on thermal coal imports. We analyse India's response.

The next article in this edition of our Bulletin focuses on the advantages of arbitration in Dubai for disputes involving Gulf Cooperation Council and Indian parties. Finally, we look at a recent English appeal decision which has sought to confine potentially widely drawn exemption clauses, in a judgment which may have important implications for the interpretation of mutual indemnities and knock-for-knock clauses.

Should you require any further information or assistance on any of the issues dealt with here, please do not hesitate to contact any of the contributors to this Bulletin or your usual contact at HFW.

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The new gas gold rush – an Indian perspective

The energy industry is in a state of flux. Until very recently, oil was the undisputed king, responsible for fuelling global economic growth in the last half century.

Renewable energy holds the key to stemming the perilous trend of global warming. But for now, natural gas is steadily increasing its share in the world's energy mix. Natural gas is cleaner and has lower carbon intensity than both oil and coal. Perhaps most importantly, gas can increasingly be sourced more reliably than oil.

Governments are increasingly motivated by carbon emission reduction targets and an effort to diversify energy supplies. Countries such as India have increasing energy demand and mounting pressure to implement emissions reduction policies and diversifying energy sources.

The demand for gas in India has risen quickly across the industrial, residential and power sectors. Recent data indicates LNG imports were 7.96 million tonnes in FY2008-09, 8.9 million tonnes in FY2009-10 and 8.86 million tonnes in FY2010-11[1].

India's gas market can expect to see higher production and exploration activities as a result of the government approving new gas pricing. The implication is that gas prices are to be raised from US$4.2 to US$8.4 per million BTU. As a result of the new gas pricing formula, it is expected that companies will be incentivised to increase gas production.

In line with this, India has set up a committee to review future Production Sharing Contracts (PSCs) with oil and gas companies. The purpose is to *'enhance production of oil and gas and the government's share'* while *'minimising procedures for monitoring the expenditure of producers'*[2]. India will allow foreign oil and gas companies to bid in its first round of shale-gas licensing, which is expected in 2013 as part of efforts to fast-track exploration for unconventional resources.

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PAUL DEAN

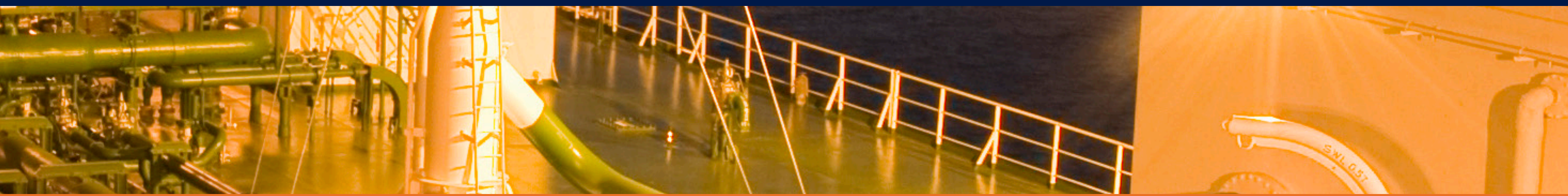
So far, the global dash for gas has focused on discoveries of shale gas – natural gas trapped inside shale formations – and other forms of unconventional gas. These have already revolutionised the global energy picture, roughly doubling the world's gas resources that may be economically recovered. Although the gas rush has so far centred on shale gas, new technology could soon provide what is considered to be a more environmentally sustainable, and potentially cheaper, alternative.

Liquefied natural gas (LNG) holds the key to exporting gas, providing a means to transport it from its source to the worldwide market. At present, India has two functioning LNG terminals, giving it a total import capacity of 13.6 million tonnes per year. At the beginning of 2013, the development of a new LNG terminal was given the go-ahead by Petronet's board. Completion is expected to be in 2016 and will provide the south east of the country with 5 million tonnes of LNG per year.

Floating liquefied natural gas (FLNG) is a revolutionary (and as yet untested) concept, combining onshore LNG techniques with offshore oil and gas development technologies and environments. An FLNG unit should theoretically be able to produce, liquefy, store and transfer LNG at sea before carriers ship it directly to markets. A number of offshore floating liquefaction and regasification projects are in the planning stages across the globe. FLNG vessels are used in the production, liquefaction and offload of LNG to carrier ships, and enable access to remote offshore natural gas fields left unexplored and undeveloped due to high development costs that traditional LNG facilities would necessitate. Offshore LNG facilities can also mean inland environmental laws are not applicable, and the facilities can be transferred to new locations in response to industry need[3]. FLNG technology can reduce both the cost and the environmental footprint,

1 India Oil and Gas Report Q4 2013, Business Monitor International, p. 28

2 Ibid, p. 7



because there is no need for longer pipelines, compression platforms to push the gas to shore, dredging and jetty construction, or onshore development such as roads.

This should allow flexibility for natural gas drilling operations and terminals to be placed directly over an offshore field, and relocated simply and quickly once the field is dwindling, or even in cases of severe weather.

For the years 2012–2016, a total of 20 FLNG regasification terminals are planned across 13 countries, representing 3,488.5 billion cubic feet capacity addition. With the addition of these FLNG regasification terminals, FLNG capacity will account for 11.3% of global LNG regasification capacity[4].

Within the next four years, India is set to have two operational terminals, namely Kakinada FLNG (Shell) in Andhra Pradesh and Pipavav FLNG in Gujarat. Shell state they plan to invest US$1 billion in constructing the FLNG terminal offshore in Kakinada, with capacity to import 5 million tonnes of LNG per annum, which they say may be doubled later on.

In theory, the future of global FLNG appears rosy. In practice, the industry has several major obstacles to overcome. The sheer size of the units involved are the key concern. It is feared that the salvage industry could be stretched to the absolute limit in the event of an accident at sea, as the industry lacks the tugs, cranes and other equipment to handle the largest potential incidents. Historically, when shipping has gone into new areas, the safety aspects have perhaps not been looked at as carefully as they could have been. It is unclear whether enough has been done by international oil majors in terms of their risk assessments.

The need for wreck removal in deep water is also a major concern. There is also a heightened risk of collision where shuttle tankers are operating from FLNG units taking off gas, as well as potential fines for any infringement of local operational rules. Legal questions also remain over the FLNG business, particularly whether FLNG units will be treated as trading ships from a legal and regulatory perspective, or as permanent offshore installations.

Unless there is a right to limit liabilities under the convention that applies to ships, owners and insurers may be exposed to liabilities outside their direct control, which may exceed the capital value many times over. For example, if an FLNG unit were to collide with a rig, it could result in huge loss of life and massive claims by rig owners. If the unit was to be considered a ship, there would be a limit to the liabilities with respect to claims by reference to the tonnage of the vessel. This limit gives some certainty to the insurers of the degree of potential loss. However, it is currently unclear whether the owners of an FLNG unit would be able to limit in this way. As there have been no court cases, there is no current guidance on the likely position.

Much remains to be resolved if offshore gas is to be the revolutionary development that many hope.

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A version of this article first appeared in the July 2013 edition of HFW's magazine, International Commerce.

India's thermal coal imports – a long and winding road

By 2014, India is expected to overtake Japan as the second largest importer of thermal coal in the world. Shortly thereafter, it is expected to overtake China as the largest importer of thermal coal in the world. This seems counterintuitive given India has the 5th largest coal reserves in the world.

In this article, we look at some of the reasons behind India's increasing reliance on thermal coal imports, some of the consequences of that reliance and the measures the Government of India (GOI) has implemented or is contemplating to reduce that reliance.

India's coal imports

India is a net importer of thermal coal. Its domestic production is insufficient to meet its required coal supply. Indian imports of thermal coal, used primarily as a fuel for power generation, have grown at a staggering compound annual growth rate (CAGR) of 32%, from 39 MT in 2008/09 to 118 MT in 2012/13. In the quarter ending June 2013, India imported over 36 MT of thermal coal. If June 2013 imports of 12.73 MT are annualised, this equates to imports of 144 MT for the fiscal year ending 31 March 2014, an increase of more than 60% over the previous fiscal year.

By 2014, India is expected to overtake Japan as the second largest importer of thermal coal in the world.

3 Research and Markets: Floating LNG Terminals Industry – Global Market Analysis, Competitive Landscape and Planned Projects to 2016

4 Ibid.

Indian coal supplies

The power sector accounts for around 80% of India's thermal coal demand (the others being cement, direct reduced iron and brick manufacturing).

India faces a number of challenges on the coal supply side:

- Production at a number of large coal mines has ceased due to technical problems or declined due to them reaching maturity.
- The development of new mines has been delayed pending land acquisition and the issue of forestry and other environmental clearances or deferred due to the current low coal price.
- Many coal mines are underground making them more expensive and more technically challenging to mine than open-cut mines.
- Indian coal has a high ash content generally (resulting in lower heating values).

The coal supply deficit was around 70 MT in 2012. This is likely to increase substantially, with demand for thermal coal expected to rise 43% to 730 MT in 2017 while supply from domestic sources is expected to rise only 38% in the same period.

Natural gas, an alternate fuel for power generation, is not an immediate solution. It is being consumed by India at the fastest rate in Asia. The share of gas-fired generation capacity is expected to fall to just 3% in 2030, from 9% in the fiscal year ended 31 March 2013.

Consequences of India's import reliance

India's reliance on coal imports has various consequences:

- The current low value of the Indian rupee means imported coal is significantly more expensive than domestic coal.
- Projected Indian coal demand could limit coal supplies in the Asia-Pacific region generally giving foreign producers the power to increase prices.
- Increased imported coal prices will mean more expensive electricity for customers in India and have an adverse effect on India's current account deficit.
- Increased imports will put additional strain on India's ports and transport infrastructure.
- Increased imports will result in new generating capacity being constructed close to India's ports in order to reduce logistics costs.

> If implemented, the proposed measures by the Government of India would mark an unprecedented milestone for private investment in India's lucrative domestic coal industry. Nevertheless, India will be relying on thermal coal imports to plug the supply deficit for many years to come.
>
> JAMES DONOGHUE

What is the Indian Government's response?

In June 2013, the GOI announced plans allowing power companies to pass on the cost of imported coal fully to consumers. Previously the power companies had been unable to do this. The move is directed at ensuring adequate coal supplies to power plants (many of which are running at 50% capacity) and to encourage additional investment in power generation capacity.

Other measures proposed by the GOI to augment domestic coal production include:

- Permitting excess coal from 'captive mines' (mines allocated to a specific use) to be sold to Coal India Limited (CIL).
- Enabling private companies to partner with CIL in PPPs or joint ventures.
- Allowing CIL to outsource more of its mines for development by private companies.
- Requiring CIL to supply 65% of power project coal from domestic sources, increasing to 75% in 2016/2017.

If implemented, the proposed measures by the GOI would mark an unprecedented milestone for private investment in India's lucrative domestic coal industry. Nevertheless, India will be relying on thermal coal imports to plug the supply deficit for many years to come. As Lennon and McCartney said, the long and winding road [may] never disappear.

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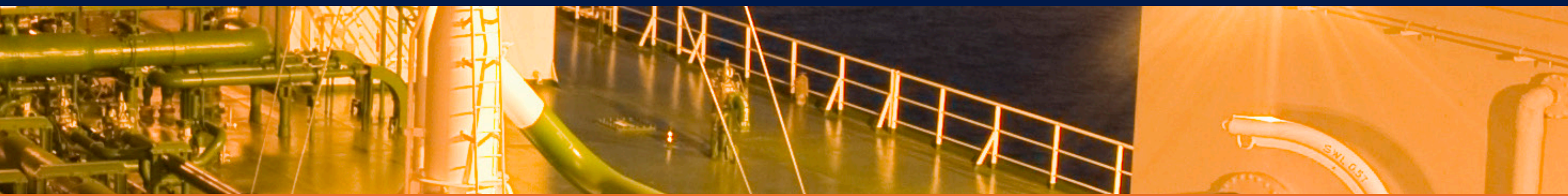

DIFC Arbitration – a powerful tool for the GCC-India trade

The Gulf Cooperation Council (GCC) (comprising Bahrain, Kuwait, Oman, Saudi Arabia and the United Arab Emirates) is the largest single economic bloc among India's trading partners. GCC-India trade, by some estimates, is in the region of US$160 billion a year. Among individual states, the United Arab Emirates (UAE) is India's largest trade partner. India-UAE trade reached US$75 billion in 2012-13 after years of steady growth. These high trade levels make the occasional dispute almost inevitable, and the hunt for effective dispute resolution options is always an ongoing one.

Litigation is not usually a preferred option due to the historically slow pace of the local courts, and the differences in legal systems and language. Arbitration too has had its share of challenges, as enforcement of awards has always been a concern. The 2012 decision of the Supreme Court of India in the Bharat Aluminium case, and the recent, more positive approach of the GCC Courts to the enforcement of foreign awards go some way to address the issue. However some challenges remain.

For example, the GCC States' signature of the New York Convention on the Enforcement of Foreign Arbitral Awards has not been uniformly followed by meaningful changes to the domestic arbitration laws. This can mean that the enforcement of foreign awards can be refused because the award does not comply with local procedural requirements, although those requirements do not apply in the seat of the arbitration. As a result, participants in India-GCC trade are seeing that arbitration in London, Paris or Singapore may not necessarily be the most effective way of dealing with their disputes.

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Surprisingly, against this backdrop, Dubai is often overlooked despite being a regional arbitration hub (the UAE is home to at least three arbitral institutions).

Dubai plays a central role in the India-GCC trade as the region's de facto trade capital, and is home to the Dubai International Financial Centre (DIFC), one of the few common law jurisdictions in the GCC. An arbitration seated in the DIFC offers several distinct advantages to the India-GCC trade. Within the DIFC, the DIFC-LCIA Arbitration Centre offers the same rules and high level of service for which its parent, the London Court of International Arbitration, is well known. In addition, the DIFC Courts have supervisory jurisdiction over DIFC-seated arbitration; as common law courts, their power to issue interim relief is much more flexible than the "onshore" civil law courts in the wider GCC.

Importantly, the UAE-India Bilateral Agreement on Judicial Cooperation in Civil and Commercial Matters (Bilateral Agreement) provides for the mutual enforcement of arbitral awards, and the only limitations imposed by the Agreement are that there should be a written arbitration agreement and the matter should be arbitrable in the State in which enforcement is sought (unless the enforcement of the award is contrary to the public policy of that State).

The Bilateral Agreement provides an important pathway for traders in the GCC and in India. For Indian traders wishing to enforce an award in the GCC, the GCC Convention allows for the enforcement of a UAE award in any of the GCC States by converting the award into a Dubai court judgment. The conversion of a DIFC arbitration award into a Dubai Court judgment is a fairly straightforward process, thanks to a Memorandum of Understanding between the DIFC Courts and the Dubai Courts. For GCC traders wishing to enforce an award in India, the Bilateral Agreement offers a potential alternative to enforcement under the New York Convention, as the grounds for challenge are more limited.

In terms of costs, Dubai compares very favourably with the traditional arbitration centres. The fees of the DIFC-LCIA arbitration centre are based on time spent rather than on a percentage of the claim value. In addition, there are significant savings to be made in respect of travel time for parties as well as professional resources such as barristers, surveyors, and expert witnesses.

Dubai is a short distance from all the major GCC and Indian cities, and there are a large number of direct flights each day. Further, Dubai is practically in the same time zone as the rest of the GCC and India, which greatly assists in setting up telephone and video conferencing within the same business hours; which is often a challenge in London or Singapore arbitration involving Indian or GCC parties.

For these reasons, Dubai is increasingly an attractive arbitration venue.

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Uncertainty returns to knock-for-knock?

A recent appeal decision has continued the consideration of the scope and effect of potentially widely drawn exemption clauses and, in attempting to give a sensible construction to such clauses, has sought to confine them to breaches in relation to defective performance under the contract rather than a refusal or failure to perform the contract at all.

The Court of Appeal's decision in *Kudos Catering (UK) v Manchester Central Convention Complex* (and the preceding cases) has potential ramifications for common form types of mutual exclusion or exemption clauses by which parties agree to a knock-for-knock or mutual indemnification regime.

The starting point is to distinguish two principles of construction which have been in play in the cases.

The first principle supports the knock-for-knock regime. This is that there is no rule of law by which exemption clauses are to be deemed inapplicable in cases of 'fundamental breach' or the breach of a 'fundamental term': the question is simply whether the clause, on its true construction, extends to cover the obligation or liability which it is sought to exclude or restrict and nothing in principle prevents the parties from excluding or limiting liability for deliberate (and hence repudiatory) breaches of contract.

The Court here is concerned to give effect to the clear terms of the parties' contract.

The second principle pulls the other way. This is that an exemption clause may be so widely drawn and general in its scope that it must sensibly be restricted, since, if it were applied literally, it would defeat the main purpose of the contract which the parties had in mind and would be *"to deprive one party's stipulations of all contractual force"* with the result of *"[reducing] the contract to a mere declaration of intent"*.

In *Kudos Catering*, Kudos agreed with a Convention Centre to provide catering and hospitality services for a period of five years.

Three years into the contract, Manchester Central Convention Complex decided to terminate the contract. Kudos asserted that MCC's termination was wrongful and repudiatory and claimed damages for breach of contract including a claim for £1.3 million damages for substantial financial losses in respect of lost profits.

MCC sought to rely on what it contended was a widely drawn exclusion clause, Clause 18.6, in its favour. On a trial of a preliminary issue, the Court of Appeal rejected MCC's argument, holding that the clause did not apply to a repudiatory breach of the contract.

The Court of Appeal arrived at its decision by a number of routes, however, the general approach followed was applying the second principle that it could not be presumed that the parties would have intended to exclude all liability and that the clause had to be cut back in that light.

As Lord Justice Tomlinson put it: *"In order to construe the provision consistently with business common sense, I would regard the expression "in relation to this agreement" as meaning in this context "in relation to the performance of this agreement", and thus as not extending to losses suffered in consequence of a refusal to perform or to be bound by the agreement. […] In my judgment however by their language and the context in which they used it they demonstrated that the exclusion related to defective performance of the agreement, not to a refusal or to a disabling inability to perform it."*

That approach has distinct echoes of the decision of Mr Justice Teare in (2009) The *A Turtle*, a case on Clause 18 of the pre-2008 "Towcon" form, where a similar approach was taken to the standard exemption of the tugowner's liability for damage to the tow.

The Judge in that case held obiter that the clause applied so long as the tugowner was actually performing its obligations under the contract, albeit not to the required standard, but not when he had ceased to do anything at all in the performance of its obligations. While he accepted that the wide words of Clause 18 were capable of applying to all breaches (a point emphasised in the BIMCO 2008 revision which now refers to "any breach"), he held it did not apply to what he described as "radical" breaches or outright refusal to perform the contract at all.

However, by way of contrast, in *AstraZeneca UK Albemarle International*, Mr Justice Flaux trenchantly rejected the 'presumption' approach taken in *Internet Broadcasting* as fundamentally misconceived and inconsistent with authority.

He said: *"Even if the breach ... of its obligation to deliver ... had been a deliberate repudiatory breach ..., the question whether any liability ... for*

> ...draftsmen may need to be willing to spell out that they mean to cover any and all breaches of contract, especially in the context of knock-for-knock clauses...

damages for that breach was limited ... would simply be one of construing the clause, albeit strictly, but without any presumption. Since it states: "No claims ... of any kind, whether as to the products delivered or for non-delivery of the products" it seems to me it is sufficiently clearly worded to cover any breach of the delivery obligations, whether deliberate or otherwise."

Therefore, *AstraZeneca* firmly restated the first principle as the lynchpin of the modern construction of exemption clauses, be they knock-for-knock, consequential loss or otherwise.

It is unclear whether *AstraZeneca* was cited in argument before the Court of Appeal in *Kudos*.

How to reconcile these apparent divergences of approach?

Plainly, the simple argument that an exclusion clause cannot apply or should be presumed not to apply absent express language to a repudiatory breach on fundamental or radical breach principles will be rejected: *AstraZeneca*.

However, if the clause if given its full effect, means that one party is effectively discharged from any liability for any breach at all, then the clause will be cut down to 'performance' breaches only and not refusal to perform at all: *A Turtle*; *Kudos*.

While the result may be the same, the route by which it is reached is different. Indeed, Lord Justice Tomlinson in *Kudos* expressly recognised and applied the first principle. It is to be remembered also that, even in *AstraZeneca*, Mr Justice Flaux - having stressed the first principle - nevertheless then applied the second principle so as to restrict the exemption clause before him.

Where this leaves exclusion of liability for repudiatory breaches under mutual indemnities and knock-for-knock clauses, which on one view are clauses of a different type and purpose, is uncertain.

Modern BIMCO clauses are deliberately widely drawn and refer to "any breach of contract" which may be sufficient. But draftsmen may need to be willing to spell out that they mean to cover any and all breaches of contract, especially in the context of knock-for-knock clauses (where this is in fact almost invariably the subjective intention of the parties at the time of contracting) in order to avoid any risk of having a different 'objective intention' subsequently applied by a court or tribunal.

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This article is based on a piece written by Paul Dean and Simon Rainey QC, which appeared in Lloyd's List on 16 July 2013.

Conferences & Events

Diwali Dinner
Hosted at HFW Friary Court, London
16 October 2013

India Shipping Summit
Mumbai, India
21-23 October 2013
Presenting: Paul Dean – LNG shipping boom in India

Arbitration Workshop
Perth, Australia
30 October 2013
Presenting: Nick Longley, Julian Sher, Chris Lockwood

Maritime Emergencies and their aftermath
Genoa, Italy
28-29 November 2013
Presenting: Andrew Chamberlain – dealing with mega - casualty incidents

For more information about any of these events, please contact events@hfw.com

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