"NEGATIVE" OIL PRICES: WHAT TRADERS NEED TO KNOW

Oil companies are currently facing a tremendous challenge. With massive oversupply in the market and storage facilities at capacity, the oil price has plummeted. The US has seen a "negative" price (sellers potentially paying buyers to take oil off their hands) for the first time in history. There is also the risk of negative prices arising in trading contracts, where price formulae involve the application of a discount to the already low benchmark price.

For traders facing the prospect of negative oil pricing for the first time, what does this mean and how can they prepare?

Analysis

It is possible for contracts to involve pricing formulae and express obligations that allow for payments to go in more than one direction. The law recognises that agreements can involve prices that are expressed to be negative but references to these in English law judgments (e.g. *British Telecommunications Plc v Telefónica O2 UK Ltd and Others*[1]) are rare.

Whilst commercially unwelcome, "negative prices" are not necessarily legally problematic where they are expressly contemplated in the agreement between the parties. However, difficulties may arise where they are not. Where a contract includes a price formula, but is silent or ambiguous on the impact of a negative resulting price, this can give rise to uncertainty as to the parties' obligations. The buyer will argue that the seller must pay them to lift the cargo. The seller will disagree.

Relevant principles

There appear to be no English legal decisions addressing negative pricing in the context of sale of goods. However, some guidance is available in the context of negative interest rates. These can also be unexpected at the time the contract is agreed and can involve a reversal of the direction in which payment is ordinarily made. In *The State of the Netherlands v Deutsche Bank AG*[2], the Court of Appeal considered whether negative interest rates were payable in the context of an annex to an ISDA Master Agreement. It found that the annex did not provide for the payment of negative interest and the Netherlands' appeal was dismissed. The Court identified the following principles:

- The key question is whether, viewed objectively, at the time of entering into the contract the parties intended the seller to pay the buyer in the event of a "negative price" arising.
- The Court will look primarily to the terms of the relevant contract to assess this. If nothing in the contract suggests that negative prices were intended or contemplated, it is likely that they are not payable by the seller.
- The Court will look at all the circumstances surrounding the making of the contract and available to the parties which would assist in determining how the contract would have been understood by a reasonable person in their position.
- Where there are rival interpretations, the Court will generally prefer those consistent with business common sense.

There is a note of caution to sound for sellers here: for commercial contracts between parties of equal bargaining power, the Court is unlikely to assist a party just because it finds it has struck a bad bargain.

Whether a "negative price" will be payable under a commodity sale contract will depend on the particular terms and circumstances of each contract and has not been directly tested before the Courts. However, our initial view is that the answer is more likely to be "no" for existing contracts which are silent on negative prices.

How does this affect you?

For **existing** contracts which do not address negative prices:

- Identify those contracts where the risk of negative pricing is greatest.
- Reach out to your counterparties and try to negotiate a sensible agreement as to what should happen in the event of negative prices arising. Record any amendments to the contract in writing. Check that you have complied with other terms of the contract which may be relevant to renegotiation, including no waiver, entire agreement and no oral modification clauses.

For **future** contracts:

- Ensure that these deal expressly with what should happen in the event of the price turning negative.
- If you are the buyer, you will want express confirmation that the seller will send any amount expressed to be negative to you, as well as the relevant cargo(es).
- If you are the seller, consider inserting a price 'floor' of zero into any contractual pricing formula, to avoid the need to make payments to the buyer. These are common in facility agreements in the context of interest rate calculations based on benchmarks.

HFW is advising clients in relation to these issues and is ready to assist.

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1 [2011] CAT 24
2 [2019] EWCA Civ 771

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