TWENTY ESSEX

The 2020 oil price rollercoaster: what disputes might manifest?

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Instability in the price of crude oil has a strong propensity to bring with it contractual and other disputes. In this short article we explore a few of the types of disputes that may arise, and recap some of the pertinent English law issues that might be relevant to their resolution.

Did the parties conclude a binding agreement?

In the context of escaping from and enforcing concluded contracts, we have seen much ink spilled recently on the interesting areas of force majeure and frustration, not least when the price of crude went negative (e.g. West Texas Intermediate's fall to minus US$37.63/bbl in April 2020).

But there are other ways a party might seek to extricate itself from a sudden and unattractive change in the economics of an agreement to buy or sell crude or crude products.

One likely candidate, if a sudden fluctuation in the market coincides with the initial stages of the parties' contractual journey, is to argue that a binding contract was never in place between the parties, and thereby seek to resile from a trade that had been on the cards, but which has, as a result of the market's volatility, become an un-economic commitment. Conversely, if the deal economics point the other way, one might find a party seeking to hold another to a nascent agreement when only a few headline (favourable) terms had been agreed.

Oil trading presents a good opportunity for these types of argument to arise given the way in which trades are concluded, often by deal recaps of varying detail and complexity, followed only later (sometimes) by the signing of a formal and detailed contract. This can present parties with plenty of opportunity to argue for or against the conclusion of a contract at any stage from the initial "in principle" agreement on a few critical terms, through to the conclusion of a signed formal agreement. Lord Clarke explained the task for the Court in *RTS Flexible Systems Ltd v Molkerei Alois Muller GmbH and Co KG* [2010] 1 WLR 753:

> *"...Whether there is a binding contract between the parties and, if so, upon what terms depends on what they have agreed. It depends not upon their subjective state of mind, but upon a consideration of what was communicated between them by words or conduct, and whether that leads objectively to a conclusion that they intended to create legal relations and had agreed upon all the terms which they regarded or the law requires as essential for the formation of a legally binding relations."*

As with so many areas of law, the devil is in the detail – and the question for any given contract as to whether and, if so when, the parties are bound, as opposed to still in negotiations from which they can walk away, is heavily fact dependent. However, there are some important legal principles that are likely to be relevant.

At the heart of these kinds of disputes will be arguments about some of the classic building blocks of any contract: offer; acceptance, and intention to create legal relations ("ICLR"). The

cases in this area particularly focus on ICLR and uncertainty, which tend to provide the most fertile ground for disputes. *Harb v HRH Prince Abdul Aziz* [2018] EWHC 508 (Ch) is a good (non oil-trading) example of how the arguments may be run incrementally. In that case, the argument against a contract existing was put on the following alternative bases in succession:

- Did an agreement in principle exist?
- If yes, was there ICLR?
- If there was an agreement and ICLR, then was the agreement void for uncertainty (insufficient key terms having been agreed).

While there is inevitably overlap between them, that triumvirate of arguments is one frequently seen in these cases.

One of the classic cases in this area is the Court of Appeal's decision in *Pagnan SpA v Feed Products Ltd* [1987] 2 Lloyd's Rep 601. There Lloyd LJ set down six key (but non exhaustive) principles to assist in identifying whether at any particular point parties to negotiations have concluded a binding agreement.

They are: (i) one must look to the parties' correspondence as a whole; (ii) the parties may agree that a contract does not come into force, even though they have agreed all of the terms they wish, until a further condition has been met [*e.g. the classic "subject to contract" position*]; (iii) the parties may agree a contract will not come into force until further terms have been agreed; (iv) the parties may intend to be bound immediately even though there are further terms left to agree, or there is a further formality left to fulfil; (v) in relation to (iv), if the parties fail to agree the further terms, the contract may still be valid unless the failure renders the contract as a whole unworkable or void for uncertainty; (vi) the parties are the masters of their contractual fate, and so the often repeated statement that it is only when essential terms have been agreed that parties are bound is actually a more nuanced point, requiring care to understand.

It will be the application of these principles, together with those set down in the other leading cases in this area, that will determine whether, on the facts of any particular case, there is a binding contract. For that reason, these issues are rarely suitable for summary determination and tend to give rise to triable issues, at least unless the case is particularly clear-cut one way or the other.

The consequences of long-term storage and ullage issues

One of the corollaries of the sharp downward shift in the price of crude in early 2020 was an oversupply, leading to huge ullage problems across the world. Not only may this lead to delays in delivery under existing contracts, but there are also at the time of writing a plethora of VLCCs being used as floating storage, pushing charter rates higher. There may be shipowners happily taking advantage of the fact this pushes charter rates higher. But there may well be hidden consequences, giving rise to disputes in due course. We give two examples.

The first is the risk of a product quality dispute. Whilst certain products, for example residual fuels (such as LSFO or HSFO), are likely to be stored in a stable fashion without suffering from a quality change, more volatile products, such as motor gasoline or LPG products, might suffer from extended storage. For these latter types of products, there can be disputes arising both under sale contracts pursuant to which they have been sold (especially if delivery is pending), and also potential recourse claims against the carrier. In relation to the sale contracts, issues arising from "final and binding" certificates of quality may arise, together with arguments about when title and risk in the affected goods was meant to pass from buyer to seller. Careful attention will likely need to be paid to the contract to ascertain the extent to which the terms implied by the Sale of Goods Act 1979 have been excluded or not (and thus whether cases like *The Mercini Lady* [2011] 2 All ER (Comm) 522 will be of relevance).

The second fertile area is the potential damage caused to vessel tank coatings and the tank's themselves (e.g. via corrosion) as the result of products being stored in vessels' cargo tanks long term. In this instance, where the primary claim may well be from the carrier against the charterer or cargo interest, one may subsequently see recourse actions under the sales contract – in particular if it is the buyer's ullage problems that have led to a request for delayed delivery (necessitating the use of the performing vessel as floating storage). Interesting questions will arise about the extent to which a buyer who is the subject of a such a claim is required to either indemnify the claimant seller or is otherwise liable in damages. Questions of causation and remoteness are likely to loom large.

JOA disputes

The low oil price and corresponding diminution in returns for the parties to a Joint Operating Agreement (JOA) increase the risk of a payment default thereunder. That brings into focus the recurring issues relating to an Operator's remedies for default in the payment of cash-calls and the

disputes that may arise in relation to the exercise of those remedies. The starting point is the supposed absolute obligation to pay underlying the "*pay now, argue later*" principle, intended to ensure continued cash-flow for the joint operations. Non-operators are incentivised to pay by the potential harshness of the Operators' escalating default remedies, e.g. loss of voting rights, production rights and then ultimately forfeiture.

There are, however, instances where these remedies may not be as effective as they might be. For example, in *Pan Petroleum Aje Ltd v Yinka Folawiyo Petroleum Co Ltd & others* [2017] EWCA Civ 1525, a Non-operator obtained injunctive relief preventing the Operator from exercising the default remedies. There is an argument that restraining the Operator's remedies erodes the "pay now, argue later" principle. But the case demonstrates that it may be open to a non-Operator to avoid the contractually agreed consequences of non-payment, by saying the "*balance of convenience*" tips in its favour, at least for the short to medium term.

Any breakdown, or even tension, in the relationship between parties to the JOA may also now be increasingly likely to lead to allegations of breach of an alleged duty of good faith. In *Taqa Bratani v Rockrose* [2020] EWHC 58 (Comm.), the Court was willing to treat a JOA as arguably a relational contract into which a duty of good faith should be applied, subject to the express terms, especially those relevant to the particular dispute arising, being inconsistent with such a duty. This remains an embryonic area of the law, likely to build upon the guidance in *Bates v Post Office* [2019] EWHC 606 (QB) that dishonesty need not be alleged, the ultimate question for the Court being whether reasonable and honest people would regard the challenged conduct as commercially unacceptable. The margin of appreciation involved in that test only reinforces the scope it provides for parties to raise complaints (even if just to stall for time) under JOAs, for example in relation to the exercise of default remedies.

This article does not constitute, and should not be relied upon as, legal advice. The views and opinions expressed in this article are those of the authors and do not necessarily reflect the position of other members of Twenty Essex.

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