

# OVER A BARREL: WHAT IS REASONABLE IN THE EXERCISE OF CONTRACTUAL CONSENT PROVISIONS?

14 SEPTEMBER 2020 • ARTICLE



Many relational contracts, such as leases or long-term supply or service agreements, include provisions allowing one party to vary the contractual relationship subject to the consent of the other party. In the recent case of *Apache North Sea Ltd v INEOS FPS Ltd*<sup>1</sup>, the English High Court has provided welcome guidance about how such provisions are to be applied, and how the 'reasonableness' of decisions to withhold consent can be assessed. The Court found that contractual consent provisions cannot be used for a collateral purpose in order to coerce a significant alteration of the rights enjoyed by one party under that contract. The principles arising out of this case are not only relevant to long term concession, off take and transportation agreements in the energy and mining sectors but are generally applicable to all (particularly long-term) commercial contracts with such consent provisions.

"This case confirms that the English courts will be reluctant to permit parties to a contract to fundamentally re-write their bargain and allocation of risk."

## BACKGROUND

The dispute related to a Transport and Processing Agreement (TPA) which allowed Apache to move oil from three oil fields in the North Sea through the Forties Pipeline System (FPS), a pipeline system owned and operated by INEOS.

INEOS acquired the FPS from BP in 2017. It has recently embarked upon a £500m programme of investment into the FPS, seeking to extend its lifespan into the 2040s. This comes after a hairline fracture in the FPS, just months after INEOS's acquisition, resulted in a lengthy shutdown that forced Apache, Shell, BP and Total to temporarily cease production<sup>2</sup>. With further shutdowns for planned maintenance scheduled for 2021 (postponed from 2020 as a result of Covid-19), it is unsurprising

that INEOS is seeking additional revenue from the users of the FPS<sup>3</sup>.

The TPA is a 'send or pay' contract: it requires Apache to move (or pay for) a particular quantity of oil per day, up to a fixed maximum quantity. In return, its right to access the maximum entitlement is contractually protected. The fixed maximum quantity (derived from Apache's estimated quarterly production profile) is set out in Attachment F to the TPA. Clause 5.05(a) of the TPA allows Apache to amend Attachment F, and amend its estimated production profile, subject to:

- there being uncommitted capacity in the FPS; and

- INEOS's consent, such consent being not unreasonably withheld.

Apache sought to amend its production profile in Attachment F to the TPA, which only covered the period up to the end of 2020, to extend it through to 2040. The consequences of any failure to agree the amendment were a matter in dispute between the parties, but INEOS contended that the result would be that Apache would have no guaranteed entitlement to any capacity in the FPS beyond 2020.

INEOS stated that it was only willing to consent to the amendment if Apache agreed to pay an increased tariff under the TPA.

The High Court, in a trial of preliminary issues, was asked to determine the proper construction of Clause 5.05(a), and whether or not INEOS was acting reasonably, or 'non-contractually', by refusing to consent to the amendment to Attachment F unless Apache agreed to pay an increased tariff.

## THE DECISION

The vast majority of cases considering contractual consent provisions are landlord and tenant disputes – for example, where a landlord has refused consent for an assignment or sub-lease.

Mr Justice Foxton primarily relied on the recent Supreme Court decision in *Sequent Nominees Ltd v Hautford Ltd*<sup>4</sup>. Prior to *Sequent Nominees*, the English courts had been inconsistent on the extent to which the reasonableness of a landlord's decision to withhold consent is a question of fact or a question of law. Put another way – whether 'reasonableness' should be assessed by reference to the terms of the bargain between the parties, or according to some objective standard of rationality.

"Consent clauses should be construed, as a matter of law, on the basis that 'they are not ordinarily intended to allow the consent-provider to override or nullify a contractual right conferred elsewhere'."

In *Sequent Nominees*, Lord Briggs JSC writing for the majority cautioned against courts substituting their own judgement for that of the contractual decision maker. However, in determining the scope of the contractual decision maker's power, the Court made clear that it was necessary to construe the consent provision, in the context of the contract as a whole, to determine what the decision maker was empowered to do and to consider.

Drawing on this, Mr Justice Foxton said:

"[J]ust as it is important for the court not to trespass on issues which are properly part of the evaluative exercise for the consent-provider under the guise of construing the contract, it is legitimate for the court to consider to what extent the parties can have intended that one party would be subject to the risk of an adverse decision by its counterparty on a particular matter... [subject] only of a requirement of good faith and rationality".

In that context, Mr Justice Foxton stated that it would be unreasonable for a contractual decision maker to impose a condition on the grant of consent which would fundamentally re-write the bargain between the parties. Rather, consent clauses should be construed, as a matter of law, on the basis that 'they are not ordinarily intended to allow the consent-provider to override or nullify a contractual right conferred elsewhere'. Mr Justice Foxton accepted that a condition could be imposed to compensate for or mitigate the consequences of providing consent – for example, requiring a tenant to guarantee the obligations of a potential assignee with poor credit. However, it could not be used to 'impair a right which the party seeking consent enjoys under the contract.'

**"Parties should take care in drafting contractual decision-making powers, avoiding, where possible, difficult to assess normative standards such as 'reasonableness' or 'good faith'."**

## APPLICATION

The Court found that on its proper construction, the TPA both entitled and required Apache to move all of its North Sea oil<sup>5</sup> through the FPS for the duration of the agreement. Contrary to INEOS's case, the TPA was operative for the life of the field or until a termination event arose, not just until 2020 (with an option to extend). Whether or not Attachment F contained an accurate production profile did not affect Apache's right to transport and process its oil through the FPS. Accordingly, given that right could not be affected by any amendment to Attachment F, it was unreasonable and inconsistent with Apache's contractual rights for INEOS to condition its consent for an amendment to Attachment F on an increase in the tariff set by the TPA.

## KEY TAKEAWAYS

Consistent with recent authority<sup>6</sup>, this case confirms that the English courts will be reluctant to permit parties to a contract to fundamentally re-write their bargain and allocation of risk, even where a contract is drafted to allow for some flexibility in the relationship.

In agreements involving consent provisions:

- the matters which a contractual decision maker can take into account will be constrained by the terms of the agreement;
- it will be unreasonable for a contractual decision maker to impose a condition that increases its rights under the contract at the expense of the counterparty; but
- a conditional consent may be legitimate where the condition mitigates a risk, or compensates for the consequences, of granting consent.

However, consent provisions do not enable a contractual decision maker to put the other party over a barrel, so to speak.

In order to ensure greater contractual certainty, parties should take care in drafting contractual decision-making powers, avoiding, where possible, difficult to assess normative standards such as 'reasonableness' or 'good faith'.

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[1] [2020] EWHC 2081 (Comm).

[2] M. Lammey, “Forties shutdown leaves North Sea industry down £20m per day” (published 13 December 2017), <https://www.energyvoice.com/oilandgas/north-sea/158729/forties-shutdown-leaves-north-sea-industry-20m-per-day/>

[3] R. Millard, “Sir Jim Ratcliffe accused of North Sea price hike” (published 11 January 2020), <https://www.telegraph.co.uk/business/2020/01/11/sir-jimratcliffe-accused-north-sea-price-hike/>

[4] [2020] AC 28.

[5] Subject to some narrow exceptions for newly discovered reserves.

[6] For example, see: <https://www.wfw.com/articles/what-were-we-thinking-new-guidance-on-rectification-of-contracts/>

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