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Case No: A3/2015/3357

IN THE COURT OF APPEAL (CIVIL DIVISION)

ON APPEAL FROM THE HIGH COURT OF JUSTICE

QUEEN’S BENCH DIVISION

COMMERCIAL COURT

MR JUSTICE LEGGATT

2013FOLIO305

Royal Courts of Justice

Strand, London, WC2A 2LL

Date: 01/11/2016

**Before :**

VICE PRESIDENT OF THE COURT OF APPEAL LORD JUSTICE MOORE-BICK

LORD JUSTICE CHRISTOPHER CLARKE
and

LADY JUSTICE KING

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**Between:**

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| --- | --- | --- |
|  | **Scottish Power UK PLC** | Appellant |
|  | **- and -** |  |
|  | **BP Exploration Operating Company Ltd and Others** | Respondents |

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**John McCaughran QC and Laurence Emmett** (instructed by **Clyde & Co LLP**) for the **Appellant**

**Helen Davies QC and Richard Eschwege** (instructed by **Herbert Smith Freehills LLP**) for the **Respondents**

Hearing dates: Wednesday 5th October 2016

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Approved Judgment

**Lord Justice Christopher Clarke:**

1. On 4 February 1994 Scottish Power UK PLC (“Scottish Power”), the claimant and now appellant, made a series of materially identical long term gas sale and purchase agreements (“the Agreements”) with the respondents as sellers (“the Sellers”). The Agreements contemplated daily deliveries of gas from a field in the North Sea known as the Andrew Field over a period of 25 years or more. In May 2011 the Sellers decided to close down (or shut-in) the facilities necessary to produce gas from the Andrew Field for an extended period in order to tie it in with a neighbouring field – the Kinnoull Field. In the event the shut-in lasted for some 3½ years during which no gas was delivered. The issue with which this appeal is concerned is as to the compensation to which, in one form or another, Scottish Power is entitled under the Agreements.
2. The Agreements, in which words with capital letters are defined terms, are lengthy and complex documents. The scheme of them is as follows. Under Article 6.12 the Sellers were bound to deliver on each Day at the Delivery Point the quantity of Natural Gas properly nominated by Scottish Power. By Article 6.13 Scottish Power was obliged to make weekly nominations of gas to be delivered over the following week. If it failed to do so it was to be deemed to have made a nomination in the amount of the most recent preceding Daily Nomination.
3. Article 7.1 of the Agreements provided:

*"Throughout the Contract Period the Seller will, in accordance with the Standard of a Reasonable and Prudent Operator, provide, install, repair, maintain and operate those Seller's Facilities which are (in the opinion of the Seller and the other Sellers) necessary to produce and deliver at the relevant times the quantities of Natural Gas from the Andrew Field which are required, in accordance with the terms of this Agreement, to be delivered to the Buyer at the Delivery Point."*

The “*Seller's Facilities*” were defined in Article 1 of the Agreements to mean:

"*the production wells, platforms, separation, processing and treating equipment, pipelines and other equipment … whether or not owned by the Seller and the Other Sellers installed or used for the purpose of producing Natural Gas from the Andrew Field and delivering the same at the Delivery Point under this Agreement."*

A “*Reasonable and Prudent Operator*” was defined in Article 1 as:

"...*a Person seeking in good faith to perform its contractual obligations and, in so doing and in the general conduct of its undertaking, exercising that degree of skill, diligence, prudence and foresight which would reasonably and ordinarily be expected from a skilled and experienced operator engaged in the same type of undertaking under the same or similar circumstances and conditions, and the expression the 'Standard of a Reasonable and Prudent Operator' shall be construed accordingly*."

1. Article 16, headed “*Default*”, contained provisions in relation to underdeliveries.
2. Article 1.1 defined “*underdelivery*” as:

*“…a failure by the Seller to deliver an amount of Natural Gas which the Seller was obliged to deliver in accordance with the Buyer's proper nomination and of which the Buyer was able to accept delivery and 'underdeliver' and 'underdelivered' shall be construed accordingly."*

1. Article 16.1 provided:

*"In respect of any Day … on which an underdelivery occurs, a quantity equal to the difference between the amount properly nominated under this Agreement … and the amount delivered by the Seller shall be calculated and such quantity shall be classified (subject to the provisions of Clause 16.3) as 'Default Gas'."*

1. Article 16.2 provided a mechanism whereby quantities of Default Gas to which Scottish Power became entitled were aggregated on a monthly basis and then drawn down when deliveries were next made so that, in respect of gas delivered under the Agreement, the Default Gas Price was payable until all the gas classified as Default Gas had been drawn on. The Default Gas Price was 70% of the Contract Price.
2. Article 16.3 provided that there should not be treated as Default Gas any amount which the Seller did not deliver by reason of Force Majeure.
3. Article 16.4 dealt with the situation where the Agreement was terminated at a time when there was an outstanding amount of Default Gas which had not been delivered. It provided for a payment to be made by the Seller to the Buyer in that event in accordance with a set formula – which was, broadly, the difference between the Contract Price and the Default Gas Price as at the date of termination of the Agreement multiplied by the quantity of Default Gas which was outstanding.
4. Article 16.5 established a procedure whereby, in respect of any day on which there was an underdelivery and for which the Sellers had notified Scottish Power before Scottish Power was required to make its nomination for that day that their ability to deliver natural gas on that day would or might be restricted for any reason, the Sellers might challenge the amount nominated by Scottish Power. Such a challenge might be made if the Sellers:

*"…..are of the opinion that the amount nominated by the Buyer is greater than the maximum amount which it is reasonably to be anticipated that in the absence of the Seller's notice ... and the knowledge thereby obtained by the Buyer of the restriction in the Seller's ability to make deliveries the Buyer would have properly nominated for the purposes of and in the ordinary course of its business ('the amount actually required by the Buyer')."*

1. The object of this provision was to prevent Scottish Power from exploiting its knowledge that there was going to be an underdelivery by nominating more natural gas for delivery than it would otherwise have done, so as to get the benefit of the lower Default Gas Price. If there was a dispute about whether the amount nominated was greater than the amount actually required by Scottish Power and the parties could not reach agreement, the Article provided for an Expert to determine how much natural gas was to be classified as Default Gas.

 *Article 16.6.*

1. The critical Article for present purposes is Article 16.6 which provided:

*"The delivery of Natural Gas at the Default Gas Price and the payment of sums due in accordance with the provisions of Clause 16.4 shall be in full satisfaction and discharge of all rights, remedies and claims howsoever arising whether in contract or in tort or otherwise in law on the part of the Buyer against the Seller in respect of underdeliveries by the Seller under this Agreement, and save for the rights and remedies set out in Clauses 16.1 to 16.5 (inclusive) and any claims arising pursuant thereto, the Buyer shall have no right or remedy and shall not be entitled to make any claims in respect of any such underdelivery."*

1. Throughout the period of the shut-in Scottish Power made proper nominations of natural gas for delivery on every day of the period. There was, accordingly, an underdelivery in respect of every such day and Scottish Power became entitled to Default Gas in respect of the amount nominated.
2. Scottish Power’s claim was that in failing to operate the Facilities during the tie-in period the Sellers were in breach of Article 7.1, and that, in those circumstances, it was entitled to damages for breach of Article 7.1, being the difference between the amount it had to pay for substitute natural gas and the Contract Price. The amount it had had to pay was represented by the cost of a series of forward purchases which it made to obtain substitute gas. Scottish Power accepted that it would have to give credit against any such claim in respect of its entitlement to Default Gas.
3. Leggatt J was satisfied that the Sellers were in breach of Clause 7.1 in failing to operate the Facilities and that such failure had caused the underdeliveries constituted by the failure to supply any gas against the valid nominations made. He held, however, that Scottish Power’s rights in this respect were confined to its entitlement to the delivery of natural gas at the Default Price and the payment of the sums due in accordance with Clause 16.4 by virtue of Clause 16.6. He did so on the following basis.
4. The judge accepted that it was not necessary as a matter of law for Scottish Power to prove the nominations that it actually made during the period in which there was a failure to operate the Facilities in breach of Article 7.1 (as opposed to the nominations that it would have made if there had been no such failure). But at least part of the loss that Scottish Power had suffered as a result of the breach of Article 7.1 was, he held, caused by the non-delivery of amounts of gas which were in fact the subject of proper nominations and was therefore caused by underdeliveries: see paragraph [154]. Article 16.1, he held, could have two possible meanings. A claim for damages for loss caused by an underdelivery could be described as a claim in respect of an underdelivery and the remedy claimed for such loss could be described as a remedy in respect of an underdelivery. Alternatively, the phrase could be interpreted more narrowly, as argued by Scottish Power, so as to apply only where the underdelivery was something that had to be proved in order to establish the claim or justify the remedy.
5. Starting from this point, the judge considered the commercial purpose of the clause. He thought that it was an improbable intention to attribute to the parties that, in relation to a quantity of gas for which the Buyer had automatically received an equivalent amount of Default Gas as compensation for its non-delivery, Scottish Power should also be free to pursue a claim for another remedy for the failure to deliver the same quantity of gas. The only interpretation which in his view made coherent sense of the scheme of Article 16 was that Article 16.6 was intended to dovetail with Article 16.1 so that whenever the loss for which compensation was claimed resulted from an underdelivery and therefore attracted the remedy of Default Gas this was the sole remedy for loss.
6. I agree with the judge’s conclusion for the following reasons.
7. The Agreements are carefully drafted long-term contracts for the supply of natural gas. Article 16 lays down what is in effect a contractual remedial regime in respect of underdeliveries which by Article 16.6 is intended to be comprehensive and to the exclusion of any other remedy. In any given set of circumstances, the scheme for nomination, and compensation if the nomination is not honoured, may work to the advantage or the disadvantage of either Scottish Power or the Sellers, according to the decisions that Scottish Power makes and the movements in the market. If for any given week the market price is below the Contract Price Scottish Power may choose to make a low nomination under the Agreements. If the market price is higher the value to Scottish Power of the Default Gas may or may not make up for the difference between the market and the Contract Price which represents the loss to Scottish Power from having to buy in when a nominated amount of gas is not delivered. That will depend on the market price at the time that the Default Gas is drawn down. It may be that the 30% discount on the then Contract Price covers or exceeds that loss. The Default Gas scheme is both clear and easy to operate.
8. It would seem odd that, in the case of a breach of Article 7, there should be a remedy additional to that provided by Default Gas for two reasons. First, the circumstances in which Natural Gas is not delivered are, of course, varied. But they are likely to be the result of either (i) a deliberate decision not to supply; (ii) some failure on the part of the Sellers to comply with their obligations under Article 7.1 to the Standard of a Reasonable and Prudent Operator; (iii) some non-negligent accident or mishap; or (iv) some natural e.g. geological cause. If Scottish Power is right, Article 16.6 operates so as to confine the remedy to Default Gas only in relation to categories (iii) and (iv) and, presumably, to category (i) if, but not unless, there is no breach of Article 7.1.
9. If, however, the sphere of operation of Article 16.6 is to be so confined, its application is likely to be very limited. Non-delivery because of some natural cause is likely to be rare. If what prevents delivery is some non-negligent mishap it is likely to come within the very broad *force majeure* clause, which I set out in an Appendix. But in that case the non-delivery which it causes will not give rise to Default Gas: Article 16.3. A deliberate decision not to supply when the Facilities are operating is unlikely.
10. Second, it seems to me unlikely that reasonable persons in the position of the parties would have intended the words “*rights,* *remedies and* *claims howsoever arising etc. …in respect of underdeliveries*” to refer, and refer only, to causes of action for which proof of an actual nomination and consequent underdelivery was an essential ingredient, such that Article 16.6 is not engaged in the present case because the cause of action is, or could be, based on the *hypothetical* nominations that Scottish Power would have made if the Facilities had operated. On that footing the loss in this case would have been caused by the underdeliveries; the actual nominations made would be evidence of what would have been nominated; but, because the cause of action was based on what would have been done if the Facilities had operated, rather than what was done when they did not, Article 16 would not apply. That would seem to me to involve a degree of legal finesse which commercial men are unlikely to have contemplated. It would also appear to allow the pleader to escape from Article 16.6 by pleading what would have been delivered if the Facilities had been operational rather than what should have been delivered under the nominations made when they were not. I note that paragraph 27 of the Re-Amended Particulars of Claim in fact refers to what “*should have been delivered*” during the relevant period.
11. Third, where breaches of separate obligations in Articles 7.1, 3.1 and 6.12 results in the same loss it would be natural that the parties’ intention was that the contractually agreed regime for compensation should apply to each.
12. The relevant words, which must be read as a whole, are:

*“...in full satisfaction and discharge of all rights, remedies and claims howsoever arising whether in contract or in tort or otherwise in law on the part of the Buyer against the Seller in respect of underdeliveries by the Seller under this Agreement”.*

1. The judge thought that the words that preceded “*in respect of underdeliveries*” provided no guide to the meaning of that phrase. I am of a different opinion. It seems to me that the preceding words relate in effect to causes of action – and, indeed, every possible one – and the rights, remedies and claims arising therefrom, and that the words that follow are not, therefore, intended to define or limit the causes of action to which the Article applies to those where an underdelivery following a nomination is a requisite, but to refer to the factual consequences of the breach of contract or duty in respect of which the relevant right, remedy or claim arises. I would also regard it as odd, if the parties intended Article 16.6 not to apply in the case of a breach of Article 7.1, that (a) they did not say so; and (b) that they used words of the greatest width (“*all rights…etc*”).
2. In the present case Scottish Power nominated the full amount that it could. There was in fact an underdelivery of the whole of that amount. It is the losses caused by that underdelivery in respect of which the claim is now brought. The words “*in respect of*” are very wide. In my view the right now asserted, the remedy now claimed, and the claim now brought is in respect of the underdeliveries that have taken place i.e. the failure to deliver any of that which Scottish Power nominated, which has produced the losses for which Scottish Power claims damages.
3. That the claim is of that character is apparent from the fact that, as Scottish Power accepts, it must give credit for the discount inherent in the price of Default Gas to which it is entitled by virtue of such underdeliveries – an entitlement which arose regardless of any actual nomination. Giving credit for the discount obtained in respect of the Default Gas against any wider claim for damages would itself be an extremely problematic exercise since the Default Gas Price is determined by reference to the Contract Price at the dates when the Default Gas is drawn down which will be after, possibly, in respect of some of it, a considerable time after, the date by reference to which any damages are calculated, not least because Scottish Power was entitled to reduce its nominations so as to defer the date when it received Default Gas. Further, the relevant dates may be in a new contractual year in relation to which the Contract Price is itself unknown – since that price will, itself, depend on the indices then applicable by reference to which it falls to be calculated.
4. Mr John McCaughran QC for Scottish Power contended that the judge had lost sight of the fact that there is a presumption that the parties do not intend to give up rights or claims which the general law gives them: *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd* [1974] AC 689; that clear words are required to exclude or limit that right; and that, since the judge had held that there were two possible meanings, he should have adopted the meaning which did not involve Scottish Power losing what may be very valuable rights – said in this case to amount to up to £85 million.
5. I do not regard the judge as having fallen into error in this respect. The fact that there are two possible meanings is the beginning of the inquiry, not its end. It is then necessary for the court to apply “*all its tools of linguistic, contextual, purposive and common sense analysis to discern what the clause really means*” per Briggs LJ in *Nobahar-Cookson v The Hut Group Ltd* [2016] EWCA Civ 128 [19]. If as a result of so doing the answer becomes clear the court should give effect to it even though the interpretation may deprive a party of a right at law which he might otherwise have had. It is open to parties to make an agreement which has that effect.
6. That is the approach which the judge took. He concluded that the contract only made coherent sense if Article 16.6 provided the sole remedy for underdeliveries because Article 16 represented a contractually agreed mechanism, and because it was inherently improbable in the light of the scheme and the language of Article 16.5 that, in the case of a breach of Article 7.1, there should be a different right to compensation. Further the strength of the presumption is reduced in proportion to the degree of derogation from the common law position. Article 16.6 is not a pure exclusion clause. It is a clause which replaces common law rights with a different contractual remedy, which may, in certain circumstances, be more valuable than the right to damages.
7. Mr McCaughran also submitted that, if Scottish Power’s remedy is limited to the discount afforded by the Default Gas Price, Article 7.1 has little purpose, since it gives no right to recover damages in excess of that amount when there is a breach of contract. The position ought to be that, if a breach of contract is shown, Scottish Power should recover more than that discount. I accept that the circumstances in which Article 7.1 may give a greater remedy are likely to be limited if Article 16 is a comprehensive code in relation to underdeliveries. But that does not mean that Article 7.1 is without effect. If, for instance, the Sellers were to refuse to operate the Facilities at all, they would be in repudiatory breach of the Agreements. Scottish Power could accept and claim damages. In such circumstances there would be no nominations and no underdelivery (and, hence no Default Gas) but there would be a claim for damages.
8. For the purposes of testing the issue the judge gave some consideration to what the position would have been if:
9. Scottish Power, although nominating the full amount, would have nominated less if there had been no shut-in; or
10. instead of nominating the full amount, Scottish Power had nominated less, but would have nominated more if there had been no shut-in.
11. I have some doubts as to the utility of this exercise. Scottish Power acted in what it no doubt thought to be its best interests by nominating the maximum. The Sellers, for their part, did not take advantage of Article 16.5 to assert that those nominations were more than Scottish Power would have nominated if it had not known that the Sellers could not deliver. Scottish Power could not have nominated more than it did since it nominated the maximum; and could, as the judge pointed out, hardly say that it would have nominated less if the Facilities were operating since that would imply that the nominations that it made when they were not were not genuine estimates of its requirements. Similarly, as he also pointed out, it would seem unreasonable that the Sellers could, in the context of a damages claim, assert that the nominations were not genuine estimates when they had not taken advantage of Article 16.5 at the time. The possibility of their doing so would be excluded if any claim for damages was excluded by Article 16.6.
12. As to (a) the judge thought that it made no sense that a possibility of arguing that Scottish Power would have nominated a lesser quantity if the Sellers’ Facilities had been in operation and therefore suffered a smaller loss than the loss for which it had been compensated through the remedy of Default Gas should create scope for a claim for damages which would not otherwise be available; and that, even if a lesser amount would have been nominated, the lesser amount would still have been an amount undelivered within the contractual definition and a claim for loss caused by the failure to deliver that lesser quantity would still be a claim in respect of an underdelivery. I agree. I, also, have some difficulty in envisaging circumstances in which Scottish Power could plausibly claim that they would have ordered less if the Sellers’ Facilities had been operational than they did when they were not.
13. As to (b) Scottish Power could not, in this case, say that they would have nominated more because they nominated the maximum. It was possible, however, as the judge recognised, to envisage a situation in which Scottish Power chose to make lower nominations during a period of shut-in than it would otherwise have done with a view to claiming damages for the breach rather than receiving the remedy of Default Gas.
14. There were however constraints on Scottish Power’s ability to adopt such a strategy. Article 9 contained Take or Pay provisions. If Scottish Power nominated for delivery over the course of a Contract Year less gas than its Annual Contract Quantity (ACQ), as defined, it would as a general rule be obliged to pay for the shortfall irrespective of whether the Sellers would have delivered more gas if larger quantities had been nominated. In order to avoid incurring a liability to pay for gas which was not delivered and which the Sellers were not in position to deliver during the period of the shut-in Scottish Power would have to nominate for delivery sufficient quantities of gas to reach the Take or Pay Quantity (being the ACQ less Outstanding Carry Forward Gas) for each Contract Year.
15. For the purpose of testing the argument the judge was prepared to assume that Scottish Power would have nominated larger quantities of gas than the minimum Take or Pay Quantities if the Sellers’ Facilities had operated and gas had actually been delivered during the relevant period. He held that if, in respect of a particular day or days Scottish Power could show that it would have nominated a particular amount of gas which it did not in fact nominate, the Buyer would be entitled in respect of that amount to claim damages. That claim would not be a claim in respect of an underdelivery since *ex hypothesi* there would have been none.
16. However Scottish Power would not, he held, be entitled to recover the whole of the difference between the Contract Price and the market price in respect of the extra gas that it would have nominated if the contract had been performed. If the Buyer had nominated the quantity of gas that it actually required it would not have received that quantity but would have received a compensatory benefit in the form of an entitlement to Default Gas. The cause of its failure to receive that benefit would not have been the Sellers’ breach of contract but its own tactical choice not to nominate the amount of gas that it actually required for use in its business. In those circumstances Scottish Power would have to give credit for the Default Gas which it had chosen not to receive.
17. Scottish Power submits that it would be very odd to impute to the parties the intention that, in the circumstances postulated, Scottish Power should be entitled to damages in respect of the extra amount that it would have ordered if the Facilities were operating but not entitled to damages in respect of the amount that it did nominate when they were not.
18. I look at the matter differently. I do not think that reasonable persons in the position of the parties would have had in mind the cunning plan whereby Scottish Power would nominate enough to ensure that it did not fall foul of the Take and Pay provision but less than it in fact required in order to claim more than a Default Gas entitlement in respect of the difference between what it did and what it would have nominated. What should reasonably be regarded as having been in their contemplation was that Scottish Power would, as it did, nominate the quantities that it in fact required or, possibly more, but not less. I do not regard the scenario postulated as a proper guide to the proper interpretation of the contract.
19. Scottish Power also submitted that as soon as it became aware of the prospective breach of Article 7.1 and the likely length of the outage it was reasonable for it to make, and it did make, forward purchases; and it suffered a loss as soon as it did so. Accordingly its loss was not caused by any underdelivery because it was suffered before the underdelivery occurred. I do not agree. The breach of Article 7.1 found by the judge, consisting of a failure to operate, did not occur until the first day of the shut-in and continued on a daily basis thereafter. Whilst the Agreements subsisted it was open to the Sellers to restart delivery or deliver substitute gas from other fields or sources under Article 5.1(9). Scottish Power’s loss crystallised each day that there was an underdelivery. The forward purchases constituted an act of prospective mitigation. There is, however, no duty on a party to mitigate damages before there has been a breach or an anticipatory repudiation which the party has accepted: *Shindler v Northern Raincoat Co. Ltd* [1960] 1 WLR 1038, 1048. Further, in principle, as the judge held, Scottish Power’s loss is to be assessed by reference to the market price of acquiring replacement Natural Gas on any given day.
20. For these reasons I would dismiss the appeal.

**Lady Justice King**

1. I agree.

 **Lord Justice Moore-Bick**

1. I, also, agree.

APPENDIX

ARTICLE 15 – FORCE MAJEURE

15.1. For the purposes of this Agreement "Force Majeure" shall mean any event or circumstance which is beyond the control of the Person affected acting and having acted as a Reasonable and Prudent Operator resulting in or causing the failure by the person affected to perform any one or more of its obligations under any relevant agreement including this Agreement (but excluding any agreement between the Buyer and any purchaser or potential purchaser or user of Natural Gas acquired by the Buyer under this Agreement) and shall include but not be limited to the aftermentioned events or circumstance (to the extent that such events or circumstances are beyond the control of the Person affected acting and having acted as a Reasonable and Prudent Operator and have resulted in or caused a failure as aforesaid), namely:-strikes, lock-outs, labour and civil disturbances, acts of God, unavoidable accidents, laws, rules, regulations or orders of any national municipal or other governmental agency, whether domestic or foreign, acts of war or conditions arising out of or attributable to war (declared or undeclared), shortage of or limitation on the use of necessary equipment or materials, labour restrictions or limitations upon the use thereof, delays in transportation, collapse or destruction of structures and failure or breakdown of plant or machinery.

Provided that where an event or circumstance beyond the control of the Buyer or, as the case may be, of its Gas Carrier acting, and having acted, as a Reasonable and Prudent Operator causes or results in the total or partial destruction, breakdown or mechanical inoperability of the Gas Carrier's facilities at any point up to the Delivery Point, such event or circumstance shall be deemed to be a Force Majeure occurrence, to the extent only that a reduction in ability to accept Natural Gas in the Gas Carrier's facilities, has resulted from such occurrence  and caused the Buyer to be unable to take delivery of the relevant part of the Natural Gas properly nominated by it under this Agreement and/or tendered by the Seller for delivery.