

Through the Strait

Safe harbour, force majeure and related issues for commercial contracts

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Uncertainty affecting transit through the Strait of Hormuz is significantly impacting the flow and stability of global supply chains. With nearly 20% of the world's oil and gas moving through the Strait, current events have created immediate and significant challenges for upstream producers, downstream buyers and the wider energy ecosystem. These effects are extending into adjacent sectors including mining, transport, logistics, aviation and manufacturing, where companies are already dealing with tighter operating conditions and mounting uncertainty.

This paper sets out ten practical considerations for businesses and their advisors as they navigate this period of heightened operational risk.

1. TRIAGE YOUR CONTRACTS

We are aware of many businesses facing immediate upstream and downstream contract supply issues. Some businesses are unable to meet supply and delivery obligations or obtain vital inputs, either at all or at viable prices. Businesses should triage their commercial contracts and take advice on their rights to affirm, vary, suspend or terminate existing arrangements.

2. MAP YOUR SUPPLY / DELIVERY OBLIGATIONS

Mapping out upstream and downstream supply and delivery obligations is critical. Some contracts will mandate minimum supply / purchase obligations. While supply is high, this will not be an issue, but given current supply constraints, many businesses are weighing up their contracts individually (and whether they can service all of them or whether some need to be suspended or renegotiated).

3. FORCE MAJEURE

Force majeure clauses vary from contract to contract and need to be interpreted properly. Misalignment between upstream and downstream

contracts, for example, receiving a force majeure notice from an upstream supplier but not having the same rights vis-à-vis downstream customers can create a critical business risk if handled incorrectly. The same applies to price adjustment clauses. Force majeure is a complex topic and getting it wrong can be costly.

4. BEWARE OF REPUDIATION AND WRONGFUL TERMINATION

Repudiation and wrongful termination are significant legal risks and can arise from, among other things, improperly claiming that a force majeure event or material adverse change event has occurred. Notwithstanding "*limitation of liability*" and "*no consequential loss*" clauses, damages claimed by an affected party can be significant, particularly if the wrongful termination leads to an affected party's formal insolvency. Be precise when alleging breaches or claiming rights under a contract and if in doubt get legal advice.

5. SAFE HARBOUR AND CONTINGENCY PLANNING

Properly advised, businesses can maximise their prospects of navigating out of the current situation by developing and implementing contingency plans. If there are immediate solvency concerns, businesses should engage legal and financial advisors to give urgent restructuring / safe harbour advice, so that directors can continue to trade while mitigating the risk of insolvent trading allegations later.

6. ENFORCEMENT AND BAD DEBTS

Many customers are facing acute financial pressures of their own, which may put outstanding credit or unpaid invoices at risk. In enforcement scenarios, many businesses are caught unaware when, on review, security that they thought they had is later found to be invalid, or where a customer goes into a formal insolvency process. Even small, technical points can have significant consequences for a secured party. Early legal advice on your options and the effectiveness of your security can mitigate these risks.

7. BEWARE OF SIDE ARRANGEMENTS / ASSURANCES

A business may have strong enforcement rights under its contracts but these can be inadvertently waived or undermined by informal communications, such as emails and text messages. Informal promises to continue supplying products, informal payment plans and other assurances can stop you from enforcing your strict, legal rights. Therefore, absolute care should be taken in all communications with counterparties where a dispute is likely.

8. MITIGATE YOUR LOSSES (AND KEEP RECORDS)

If you are faced with a potential breach by a counterparty, keeping accurate and contemporaneous records of the steps taken to mitigate your losses (for example, alternative arrangements) are critical in proving up a claim against the counterparty later. This contemporaneous record keeping should be done while keeping other recovery options (for example, insurance) in mind.

9. CLAWBACK RISK

In many jurisdictions, where payments are made in the lead up to a customer's insolvency, they are at risk of claw back if investigated by a liquidator. Properly advised, businesses can take steps today which can mitigate the risk of monies paid by customers being later clawed back by a customer's liquidator.

10. MOST DOCUMENTS ARE DISCOVERABLE

In the current environment, disputes may be brewing for months before they finally come to a head. Businesses need to be careful about the communications that they send, even internally, because most communications are discoverable in court (unless privilege or other, limited exceptions apply). Contract disputes can be won or lost off the back of stray, internal correspondence.

In periods of heightened disruption, time is your most valuable asset. The more time available, and the longer your runway, the broader the range of options that are likely able to be developed, assessed and implemented. Engaging legal and financial advisers at an early stage can assist directors and management teams to preserve value and flexibility, manage risk and make informed decisions as conditions continue to evolve.

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