

Offtake contracts: Do take or pay clauses contravene the rule against penalties?

On 29 February 2008, Burton J considered whether a take or pay clause contravened the rule against penalties in *M & J Polymers Ltd v Imerys Minerals Ltd*. Take or pay clauses are particularly common within the energy and mining sectors in long term offtake contracts. The significant financial commitment involved in developing the infrastructure for energy and mining projects leads the parties to secure the level of supply and demand throughout the duration of any supply arrangement so as to guarantee future returns on their investment. Take or pay clauses have therefore developed to the benefit of both the purchasers and the suppliers.

In this case the take or pay clause required Imerys Minerals Ltd, the purchaser, to order minimum quantities of chemical dispersants from M & J Polymers, the supplier, and to pay for minimum quantities even if they had not ordered them. Thereafter, a dispute arose between the parties regarding the quality of products being supplied and the purchaser neither took nor paid for the minimum quantities. The court ruled in favour of the supplier on the question of quality and considered the supplier's claim for damages on the basis of the take or pay clause.

The purchaser argued that the take or pay clause amounted to a penalty and should therefore be set aside. English law prohibits contractual provisions which operate as a penalty against a defaulting party e.g. a clause which states that on breach of contract, a sum shall be payable to the non-defaulting party which sum is not a genuine pre-estimate of loss would amount to a penalty. Burton J, did not dismiss the possibility of the penalty rule applying to take or pay clauses but concluded that on the facts and circumstances of the instant case the take or pay clause did not amount to a penalty as the clause was freely negotiated between parties of comparable bargaining power and was commercially justifiable and did not amount to a provision “in terrorem”.

While this case opened the possibility of take or pay clauses contravening the rule against penalties, the judgement in this case suggests that this would only occur in exceptional circumstances as take or pay clauses usually are not oppressive and operate for the benefit of both the purchaser and the supplier.

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