THE NATIONAL BUSINESS REVIEW
The Meeting Place of Intelligent Business

# Legally, very hard for Chorus to walk - and govt's bailout options limited

Michael Wigley | Monday December 02, 2013 |


Michael Wigley

The Forsyth Barr idea on Friday that Chorus [NZX: CNU] should consider walking away from the UFB contract probably isn't legally possible.

Forsyth Barr reckons that the maximum penalties would be $360 million as that's the maximum figure in the limitation of liability provision in the UFB contract.

I doubt it will be that easy as we explained in our article earlier this year, *Limitation of liability, Houdini and the Court of Appeal*. There we talked about a case where a company deliberately threw in the towel on its contract obligations, just like Forsyth Barr is saying Chorus should consider. The other party sued, but the company said that its liability was limited to low figures under a limitation of liability clause worded strongly to limit liability, just like the Chorus clause. A reading of the relevant clauses in isolation points firmly to liability being limited if the party deliberately stops providing its obligations.

Even though the courts these days tend to give effect to plain words in commercial contracts, they'll still strain things to avoid an outcome that, in their words, "flouts business common sense". If the courts can interpret the contract so that the limitation of liability doesn't apply where a party deliberately throws in the towel, they will. That is quite different from the primary target of such clauses which is breach by parties in the normal course of on-going contracts.

And that's what the court did in that case, by applying other provisions and context to read down plain words. Black became white. Houdini ruled to ensure "business common sense" prevailed.

And that is what might well happen here, despite the clear words. For example, as the judgment said: "*Had the parties intended such an exclusion of all liability for financial loss in the event of refusal or inability of the Company to perform, I would have expected them to spell that out clearly, probably in a free-standing clause…".* That didn't happen either in the Chorus contract.

So, it doesn't necessarily follow that Chorus pulling out of the contract will lead to exposure less than $360 million. I don't know what losses would amount to but it wouldn't be too surprising for them to exceed $360 million.

But that is just the start of the legal issues. Actually, the contract says that Chorus simply cannot terminate the contract except in rare circumstances not applicable here. Plus, if there are major breaches, including refusing to perform, then government, via Crown Fibre Holdings can step in to manage the relevant parts of Chorus.

That segueys into the issue of the financiers, and their covenants, who have a huge interest in all this of course.

Get to the point of ending the UFB contract and surely there will be issues for them, with some awkward issues such as who has the ownership and control rights to the built infrastructure: that's an issue that might escalate the Chorus liability to the Crown, depending on how this plays out. It's not an easy thing to sort that mess out.

In its negotiations with government, Chorus can't realistically say it might pull the pin unless a deal is done. They don't seem to have a legal choice, even before commercial issues are considered: the commercial idea of converting Chorus into a sunset business away from a long term infrastructure monopoly seems – well – strange. No wonder they've downplayed the idea of walking away.

All it can reasonably argue in negotiations is that, unless bailed out such as by a softened contract:

- Government faces a significant risk that UFB and its rural cousin, RBI, won't be delivered; and
- Chorus and not some other provider should deliver the service.

That last point has particular importance in government contracting, especially for Public Private Partnerships (PPPs) such as the UFB arrangements. It is likely that some party will deliver UFB or its equivalent if Chorus doesn't. Government might even get a better outcome. Company failure is an accepted part of business and public sector life: after all, government allowed its state owned enterprise, Terralink, to fail, by bringing in receivers, leading ultimately to liquidation. Ironically that failure was about the cost of a large infrastructure project: as the Minister said when announcing the appointment of receivers for the SOE:

> *"Terralink's current problems arise from a contract entered into in June 1999 with EDS as part of the Landonline initiative. The contract underestimated the costs and timeframes associated with this type of project and is now causing Terralink significant losses and risks."*

One of the key objectives of PPPs is to bring commercial discipline to large projects and to allocate risk accordingly. The moment government starts to bail out PPP providers or soften their terms, that disappears. That has long term implications for government efficiencies. What happens when builders of PPP schools, motorways and prisons put the hat out? "But you did that for Chorus: why not for us?"

That last bullet point is also important to preserve the integrity of government's competitive procurement processes going forwards. If you go out to competitive tender, and then the winner negotiates better terms, the procurement processes won't be trusted and won't work. They won't work for government or for consumers in the long run. And obviously they won't work for competitors that tendered such as the Regional Fibre Group which included Vector.

This procurement issue also has a free trade agreement overlay: government's procurement rules are designed to comply with the current Free Trade Agreement which was the start of the TTP negotiations. New Zealand is a strong international advocate for FTAs.

There might be reasons to bail out Chorus such as by softening its terms. But the above points indicate that they'd need to be pretty darned good reasons, even if EY reports material financial risk.

*Michael Wigley is a Solicitor acting for parties opposing the copper tax, and he acted for the Regional Fibre Group, but these views are his own*



More by Michael Wigley