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Annual Review of developments in English oil and gas law

2018 Edition

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Introduction

Welcome to the 2018 edition of the CMS Annual Review of developments in English oil and gas law

The declining oil price that started in mid-2014 has resulted in a challenging environment for the oil and gas sector around the world. However, after many years of oversupply, low prices, general uncertainty and a slowdown in exploration and development, the industry is now steadily recovering.

At CMS we have seen a noticeable increase in innovative structures in deals, as well as a rise in the number of high profile investments by private equity interests in North Sea infrastructure, creating an interesting environment for the industry in otherwise challenging times.

This Annual Review has been collated by our lawyers to be relevant to you, with a direct focus on legal developments affecting companies in the oil and gas industry. We hope that you find it interesting and of assistance in navigating the legal challenges and opportunities faced in the industry.

Please do not hesitate to contact us if you have any queries or questions.

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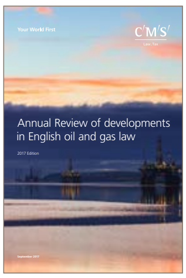
Previous editions



Previous editions of the CMS Annual Review of developments in English oil and gas law are available at **cms.law**.

From the editor

It has been a reflective few months as we have looked back at case law that has impacted the oil and gas industry around the world since the publication of the 2017 Annual Review. This year's edition deals with recent case law in relation to PSAs, JOAs, drilling units, oil and gas shipping, supply chain and EPC contracts, M&A deals and many more issues that impact the negotiation, drafting and administration of contracts in the industry.

In the past year we have seen a continuous stream of interesting decisions impacting oil and gas companies across multiple practice areas. As a result, many articles that are contained within specific chapters of this year's Annual Review could equally be applicable to other chapters.

With rising global demand and volatility in the market still prevalent, and a range of new entrants to upstream and midstream ownership, the oil and gas industry will continue to face exciting and interesting challenges. However, with challenges come opportunities, and I have no doubt that the English courts will continue to provide helpful guidance on salient legal issues arising in the sector.

I would like to thank the editorial team of Anna Rose, Alexandra Scott, Madalena Houlihan and the wider CMS support teams for their huge effort in editing this year's Annual Review. I would also like to thank the many contributors across CMS for their articles, comments and assistance. Involving teams in London, Rio, Dubai, Singapore and Aberdeen, the Annual Review continues to be a global effort.

I hope you find this Annual Review useful. Please do let us have any feedback.

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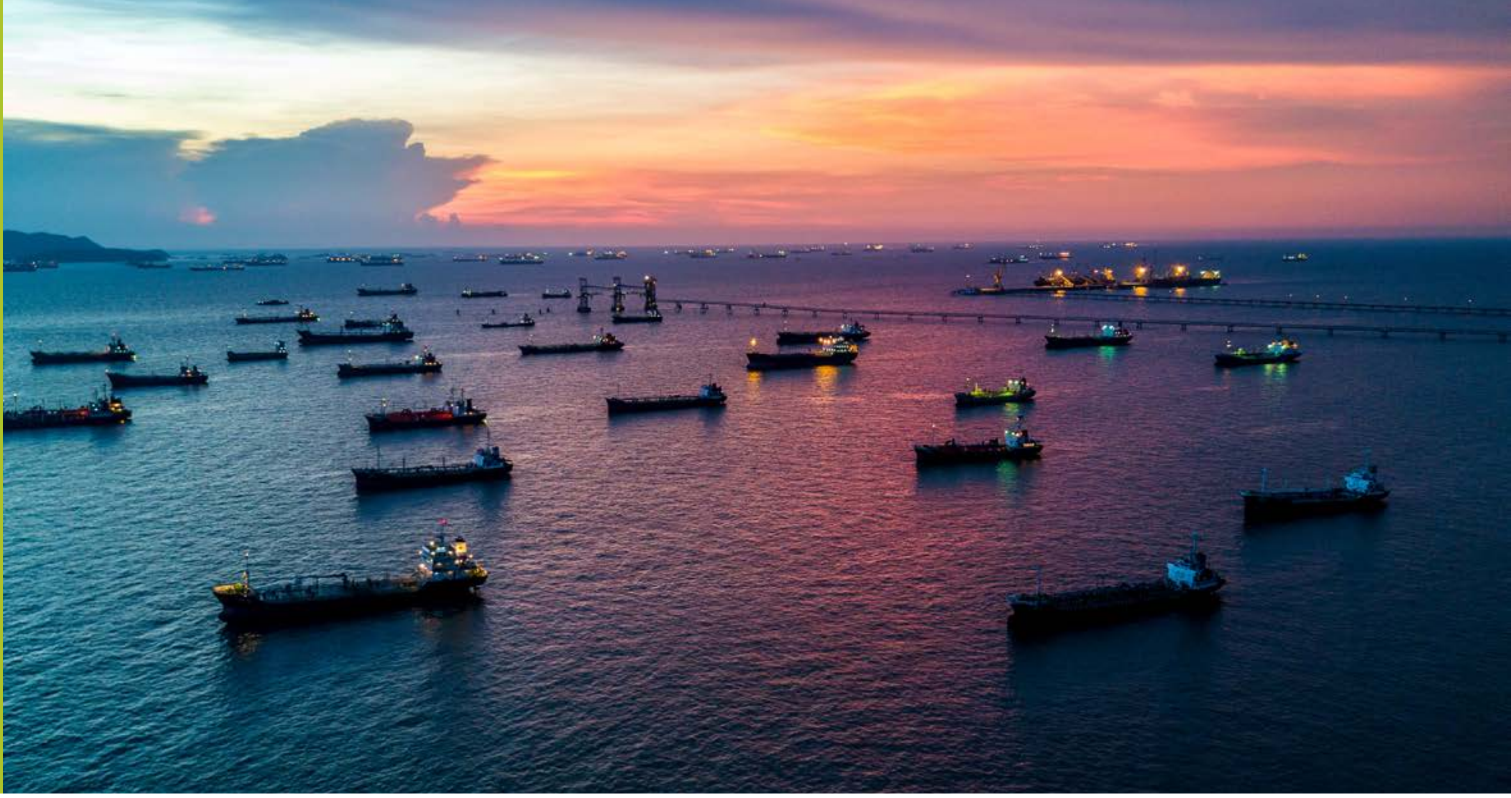


Joint Operating Agreements

The period of lower oil prices, and the associated cost pressure on oil companies, has resulted in a continued stream of interesting decisions concerning the validity of cash calls and the working of default provisions in JOAs. Interestingly, this included the English courts finally considering whether an operator could cash call costs outside the approved JOA budget.

— In *Marathon Oil UK LLC v Centrica Resources Limited, TAQA Bratani Limited and TAQA Bratani LNS Limited* [2018] EWHC 322 (Comm), the Commercial Court considered whether an operator was entitled to charge joint venture participants for pension fund shortfalls where the other participants had not approved the remedial plan concerning such shortages as part of a work programme and budget.

— In *Pan Petroleum Aje Ltd v Yinka Folawiyo Petroleum Co Ltd & Ors* [2017] EWCA Civ 1525, the Court of Appeal has upheld a decision of the Commercial Court in which an oil company was found in contempt of court for holding an operating committee meeting in the absence of an alleged defaulting party.

JOAs, budget overruns and operator pension deficits

In *Marathon Oil UK LLC v Centrica Resources Limited, TAQA Bratani Limited and TAQA Bratani LNS Limited* [2018] EWHC 322 (Comm), the Commercial Court considered whether an operator was entitled to charge joint venture participants for pension fund shortfalls where the other participants had not approved the remedial plan concerning such shortages as part of a work programme and budget. In a decision that is likely to have profound and global implications, the Commercial Court found that the operator was entitled to recover sums properly incurred to close the pension shortfall from other joint venture participants. The reasoning of the Commercial Court might also be said to apply to any work that an operator has carried out that exceeds the original approved budget.

Facts

Marathon Oil UK LLC ('**Marathon**'), Centrica Resources Limited, TAQA Bratani Limited and TAQA Bratani LNS Limited (the '**Participants**') are, and were, parties to a joint operating agreement ('**JOA**') and a unitisation and unit operating agreement ('**UUOA**') for operations in the Brae fields in the North Sea. Marathon (the '**Operator**' and/or the '**Claimant**') was designated as the operator.

The terms of the JOA and UUOA were materially similar, namely:

> *"…*
>
> *5.2 In accordance with approved programmes and budgets and under the overall supervision and direction of the Operating Committee, and subject to this Agreement, Operator shall have exclusive charge of and shall conduct all operations under this Agreement either by itself or by its duly authorized agents or by independent Contractors engaged by it.*
>
> *5.3 Subject to the provisions of any approved operating programme and budget the number of employees of Operator employed in connection with operations hereunder shall be determined by Operator. The Operator shall determine the selection of such employees, their hours of work and their remuneration, and all such employees shall be employees of Operator exclusively.*
>
> *5.4 In the conduct of operations, Operator shall:*
>
> *(a) use its best efforts to conduct diligently all operations in accordance with practices generally followed by the petroleum industry, to conform to good oil field and engineering practices and accepted conservation principles and to perform such operations in an efficient and economic manner. All operations shall be conducted in accordance with the provisions of the Licence and all applicable laws and regulations;*
>
> *…*
>
> *(g) pay all costs and expenses incurred by it in its operations hereunder promptly and when due and payable;*
>
> *…*
>
> *(j) obtain and maintain, in respect of the Joint Operations and the Joint Property, all insurance required under the Licence or any applicable law and such other insurance as the Operating Committee may from time to time determine, provided that, in respect of such other insurance, any [p]articipant may elect not to participate provided such [p]articipant gives notice to that effect to the other [p]articipants and does nothing which may interfere with the Operator's negotiations for such insurance for the other [p]articipants. The cost of insurance in which all the [p]articipants are participating shall be for the Joint Account and the cost of insurance in which less than all the [p]articipants are participating shall be charged to such [p]articipants in the proportion that each such [p]articipant's Participating Interest bears to the sum of the Participating Interests of such Participants. The Operator shall, in respect of any such insurances:*
>
> *1. promptly inform the [p]articipants participating therein when it is taken out and supply them with copies of the relevant policies when the same are issued;*
>
> *2. arrange for the [p]articipants participating therein, according to their respective Participating Interests, to be named as co-insureds on the relevant policies with waivers of subrogation in favour of the Parties; and*
>
> *3. duly file all claims and take all necessary and proper steps to collect any proceeds and, if all the [p]articipants are participating therein, credit them to the Joint Account or, if less than all the [p]articipants are participating therein, credit them to the participating [p]articipants.*
>
> *…*

(l) prepare and furnish to the Operating Committee such reports, statements, data and information as may be prescribed from time to time by the Operating Committee concerning [all operations conducted in accordance with the Agreement by or on behalf of any party with a Participating Interest];

…

5.5 (a) Without prejudice to Article 5.5(b) [which dealt with emergency expenditure] the Operator is authorised to make such expenditures, incur such Commitments for expenditure and take such actions as may be authorised by the Operating Committee in accordance with the provisions of this Agreement.

…

6.1 To provide for the orderly supervision and direction of [all operations conducted in accordance with the Agreement by or on behalf of any party with a Participating Interest], there shall be set up an Operating Committee composed of representatives of each [p]articipant. In exercising such supervision and direction, each representative on the Operating Committee shall act solely on behalf of the Party whom he represents and not on behalf of the participants as an entity. The powers and duties of the Operating Committee shall include:

(a) determination of all general policies, procedures and methods of [operations];

(b) consideration, revision and approval of all proposed operating programmes, budgets …;

…

7.2 On or before the 15th day of December of each year, the Operating Committee shall agree upon and adopt an operating programme and budget for the 12-month period beginning on the 1st day of January of the following year and for such further periods as the Operating Committee deems appropriate, which shall include as a minimum the work required to be performed under the Licence in respect of the Contract Area during such budget periods and the requirements of [the] Operator having regard to previously approved programmes and budgets and its obligations hereunder. At the time of agreeing upon and adopting an operating programme and budget, the Operating Committee shall provisionally consider, but not act upon or adopt, an operating programme for the calendar year next succeeding the period covered by such approved operating programme and budget.

…

7.10 Ongoing Liability

Following completion of Decommissioning, the [p]articipants shall remain liable for any residual liability (including in respect of remedial work) which arises at law or is otherwise imposed by regulatory authority unless and until the [p]articipants enter into a separate agreement as contemplated in Article 2.3.

…

7.11 Expenditure Overruns

The Operator shall use reasonable endeavours not to exceed the approved Decommissioning Budget but shall be entitled without prior approval of the Operating Committee to incur expenditure:

a) in excess of an approved AFE [Authorisation for expenditure] up to the lesser of ten per cent (10%) of the amount of the approved AFE and ten million Pounds (£10,000,000); and

b) subject to (a) above, in excess of an approved Decommissioning Budget up to ten per cent (10%) of the amount of the approved Budget.

Whenever it appears to the Operator that the over-expenditure for any item will exceed the amount authorised under this Article 7.11.4 the Operator shall revise the appropriate AFE and/or Budget and will seek the prior approval of the Operating Committee to incur the additional expenditure prior to entering into any further commitment, such approval not to be unreasonably withheld or delayed where the over-expenditure is necessary to comply with the Decommissioning Programme approved by the Secretary of State.

…

10.1 All costs and expenses of all operations under this Agreement in or in respect of the Contract Area or the Licence, including the handling, treating, storing and transporting, whether within or outside the Contract Area, of Petroleum produced from the Contract Area, and all costs and expenses properly incurred by the Operator in its performance of the relevant provisions of the Decommissioning Security Agreement except for costs and expenses which are solely attributable or relevant to a Party, shall be borne by the [p]articipants in proportion to their respective Participating Interests from time to time except as herein otherwise specifically provided. Furthermore, the costs of all assets, including materials and equipment acquired for the Joint Account of the [p]articipants shall be for the account of the [p]articipants in accordance with their Participating Interests from time to

> *time, and, similarly, liabilities shall be borne in such proportions.*
>
> *10.2 All costs and expenses of whatsoever kind that are incurred in the conduct of operations under this Agreement shall be determined and settled in the manner provided for in the Accounting Procedures hereto attached and marked Exhibit A, which is hereby made part of this Agreement, and Operator shall keep its records of costs and expenses in accordance with such Accounting Procedure. In the event of conflict between the main body of this Agreement and the said Accounting Procedure, the provisions of the main body of this Agreement shall prevail.*
>
> *…*
>
> *Covenant and Relationship of the Parties*
>
> *18.1 Subject to the responsibility delegated hereunder to the Operator and the Operating Committee, each Party covenants and undertakes with each other Party that it will comply with all provisions and requirements of the Licence and the applicable laws and regulations and will do all such acts within its control as may be necessary to maintain the Licence in force and effect.*
>
> *18.2 The rights, duties, obligations and liabilities of the Parties shall be several and not joint or collective, and each Party shall be responsible only for its obligations as set out herein, it being the express purpose and intention of the Parties that this Agreement shall not be construed as creating any partnership or association or as (except as expressly stated) authorising any Party to act as agent, servant or employee for any other Party for any purpose whatsoever."*

Exhibit 'A' to the JOA was entitled *"ACCOUNTING PROCEDURE"*. The Exhibit began with this statement:

> *"The purpose of this Accounting Procedure is to establish equitable methods for determining charges and credits applicable to [all operations conducted in accordance with the Agreement by or on behalf of any party with a Participating Interest] under the Agreement and to provide that Operator neither gains nor loses by reason of the fact it acts as Operator. In the event of a conflict between the provisions of this Accounting Procedure and the provisions of the Agreement, the provisions of the Agreement shall control."*

The question between the parties concerned the costs of staff employed by the Operator (in practice through an affiliate) in connection with the operations. More specifically the question was whether the Participants were liable to meet a proportion of deficit recovery charges ('**DRCs**') in respect of a defined benefit pension scheme (the '**Scheme**') of which some of those employees were beneficiaries.

The reference to a 'share' was the share of the costs of operations for which Participants were, between them, responsible. A proportion only was involved because the Scheme included some employees who did not work on operations in the Brae fields, and some who worked on operations there for some periods and on other unrelated tasks for other periods.

The Participants argued that they had no liability as a matter of contract under the JOA and UUOA. The Participants accepted that the Operator was entitled to select employees and their hours of work and their remuneration (including benefits such as pension provision). However, they argued that the Operator's ability to recharge the cost was, and remained, subject to the provisions for approved operating programmes and budgets and the direction of the Operating Committee (as defined in the JOA). They argued that Clauses 5.5(a), 6.1(e) and 7 made it clear that the Operator is not entitled to incur any expenditure in the nature of remuneration without the approval of the Operating Committee as part of a work programme and budget found in the business management plan.

The Participants argued that the Operator's approach that it was entitled to such costs, even when outside the agreed budget, involved their signing a 'blank cheque'.

They also contended that the Operator owed fiduciary, as well as contractual, duties and its breach of both relieved the Participants of liability.

Decision

In rejecting the Participants' arguments and finding in favour of the Operator, the Commercial Court decided that the scheme of the JOA and UUOA was:

- The Operator had charge of and was required to conduct all operations: see Clause 5.2.
- The Operator was to pay all costs and expenses incurred by it in its operations under the relevant agreement: see Clause 5.4(g).
- Subject to the provisions of any approved operating programme and budget the number of employees of the Operator employed in connection with operations was to be determined by the Operator: see Clause 5.3.
- The Operator was to determine remuneration (and thus the pension arrangements that would form part of that remuneration): see Clause 5.3.

- The Operator was to conduct all operations in accordance with approved programmes and budgets and under the overall supervision and direction of the Operating Committee: see Clause 5.2.
- The Operator was authorised to make such expenditures, incur such Commitments for expenditure and take such actions as may be authorised by the Operating Committee: see Clause 5.5(a).
- The Operating Committee was responsible for the orderly supervision and direction of operations: see Clause 6.1.
- This would include: (a) determination of all general policies, procedures and methods of operations; and (b) consideration, revision and approval of all proposed operating programmes and budgets: see Clause 6.1(a).
- An operating programme and budget was to *"include as a minimum the work required to be performed under the Licence in respect of the Contract Area during such budget period and the requirements of Operator having regard to previously approved programmes and budgets and its obligations"*: see Clause 7.2.
- All costs and expenses of all operations under the relevant agreements in or in respect of the Contract Area or the Licence were to be borne by the Participants in proportion to their respective Participating Interests: see Clause 10.1.
- The Operator was to prepare and furnish to the Operating Committee reports, statements, data and information: see Clause 5.4(l).
- All costs and expenses of whatsoever kind that are incurred in the conduct of operations were to be determined and settled in the manner provided in the Accounting Procedure: see Clause 10.2.
- The purpose of the Accounting Procedure was to establish equitable methods for determining charges and credits applicable to operations under the Agreement and to provide that the Operator neither gained nor lost by reason of the fact it acted as Operator: see Exhibit 'A'.
- The Accounting Procedures envisaged that often estimation might be involved: see Exhibit 'A'.
- The relevant employees were properly taken on or deployed to enable operations.
- The operations were those envisaged by the Operating Committee in the operating programmes.
- Taking on or deploying employees involved remuneration that included pension arrangements.

Against this background, the Commercial Court decided that the authorisation of the Operating Committee that first engaged the liability of participants (including the Participants) came when the operations were approved, rather than when later budgets were approved year by year.

The approval of a budget at the point when payments under the pension arrangements were required in a particular year represented approval of the amounts that were payable in respect of a liability that had already been authorised. As a consequence, the Participants were in breach of their obligations where they refused to approve budgets on the basis of a contention that they had no liability for the cost of the pension arrangements.

The pension arrangements of the relevant staff came with a cost. That cost is, and was, not fixed, and cannot be fixed. Its inclusion in a budget can only ever be as an estimate at the time, and it is important to appreciate the nature of a budget. In relation to the Participants' argument that they were being asked to give the Operator a 'blank cheque', their position would not be materially different if the Participants had employed the employees themselves to do the work on operations they wanted undertaken.

The alternative proposition that the Operator was alone responsible for some part of the pension costs attributable to employees' work on authorised operations was, the Commercial Court considered, wholly at odds with the arrangements that the parties agreed. The fact that the Operator had to work to budgets, to business management plans and under the overall supervision and direction of the Operating Committee did not involve it underwriting over-budget expenditure of this sort.

The Commercial Court specifically rejected the Participants' argument that a right to recover would require a clause along the lines of the arrangements for insurance under Clause 5.4(j). That Clause simply stipulated one method, but not the only method, of requiring costs to be shared. It dealt with a subject that had greater optionality. It did not leave arrangements in a place where the Operator would be left with a cost because others who had taken the benefit then chose not to pay the costs that resulted. The Participants' argument that it is material that there is no provision corresponding to Clause 7.10 for DRCs also failed.

The Commercial Court emphasised that its decision was not to say that there were no restraints on the Operator. The outcome in the case could have been quite different if there was a material dispute over whether the employees were required, or whether they were properly selected for employment, or as to the propriety of the Operator agreeing the pension arrangements it did.

In relation to the issue of fiduciary duties, the Commercial Court decided that the Operator's actions would not amount to a breach of such duties – so it need not decide whether it was, in law, a fiduciary. The Commercial Court, however, expressed its doubts on the issue.

Comment

The 'no loss, no gain' principle of operatorship is contained in most JOAs and regularly referenced in disputes concerning operator reimbursement. In this case, the Commercial Court was clearly swayed by the fact that it considered the *"Participants enjoyed the benefit of the employment"* of the staff in question and it would be wrong to require the associated costs/liabilities to fall to the Operator. The exception to this was that if the Operator was in breach of its obligations under the JOA to the Participants in relation to the costs claimed it might not be able to recover such costs.

Interestingly, the text of the Commercial Court's decision suggests that the relevant JOA and UUOA only expressly dealt with authorised cost overruns in the context of decommissioning budgets. It follows that the JOA and UUOA did not contain the clauses found in many JOAs, including the AIPN Model Form and Oil & Gas UK Model Form, which specifically authorise limited cost overruns by the operator for the budget as a whole and/or specified line items of the budget. As such, the Commercial Court was not required to ask whether recovery of such cost overruns by the Operator was limited to the extent permitted by such clauses in the absence of additional approval.

That said, the Commercial Court's decision will add to the debate about the circumstances in which an operator is entitled to recover costs in excess of an approved budget. In the context of pension fund liabilities, the consequences are potentially significant. The Operator in this case is far from alone in finding itself with a pension deficit. Other operators will doubtless be considering whether to adopt the same approach and prepare plans to recover pension shortfalls from joint venture partners.

Conversely, non-operators will wish to consider whether the absence of the usual provisions dealing with operator cost overruns in the JOA/UUOA in this case means that the decision of the Commercial Court is limited in its application to the facts of the case.

When it comes to drafting JOAs, non-operators might also wish to consider whether pension liabilities should be specifically addressed in accounting procedures. The issue might be more important where the Operator is an established oil company with a final salary pension scheme (or similar).

Finally, although the facts of the case relate to the pension liability for staff of an operator, the decision would be equally applicable to almost any cost-overrun concerning JOAs on the same terms. For example, if the Operator had employed a drilling unit or other vessel to carry out works approved by the Operating Committee, and the cost of operations exceeded the approved budget through no fault of the operator, it is difficult to immediately see how the conclusion would have been different. It was the reasoning of the Commercial Court that on the terms of the JOA/UUOA in dispute that once work was authorised, on terms authorised or terms specified to be agreed by the Operator, Participants were liable for the cost consequences of such work – even where this was more than set out in the relevant work programme and budget.

The Commercial Court's decision is currently under appeal to the Court of Appeal.

Judge: Knowles J

JOAs and Default: English Court of Appeal upholds restraint of remedies

In *Pan Petroleum Aje Ltd v Yinka Folawiyo Petroleum Co Ltd & Ors* [2017] EWCA Civ 1525, the Court of Appeal upheld a decision of the Commercial Court in which an oil company was found in contempt of court for holding an operating committee meeting in the absence of an alleged defaulting party.

In doing so the English courts have confirmed a willingness to intervene on an interim basis to preserve the *status quo* and prevent remedies available under a JOA from being exercised, pending the resolution of the issue in dispute by means of arbitration. In addition, they have confirmed a willingness to give force to such an interim remedy through findings of contempt.

The Court of Appeal decision is likely to have a significant impact on the conduct of joint operations under JOAs around the world, in circumstances where an issue in dispute between the JOA parties is pending resolution by arbitration.

Facts

The background facts are as follows:

Pan Petroleum AJE Limited ('**Pan Petroleum**'), Yinka Folawiyo Petroleum Co Ltd ('**Yinka**') and the other defendants were parties to an oil mining lease offshore the Federal Republic of Nigeria (the '**Oil Mining Lease**'). The relationship between the joint venture parties was governed by a JOA.

As is usual under a JOA, its terms provided for a Joint Operating Committee (as defined in the JOA) to exercise powers and make decisions in respect of joint operations. The JOA in question conferred power on the Operating Committee to vote on and pass binding resolutions as to the drilling and development of new wells, as set out in the Development Plan (as defined in the JOA). Those voting procedures varied according to the significance of the decisions being taken. Any *"major modification"* to the Development Plan or to the budget for the operations required unanimous approval. Once a budget was approved by the Operating Committee, the JOA authorised the issue of 'Cash Calls' to the parties.

In the event of non-payment of Cash Calls, the JOA contained the types of remedy typically found in international oil and gas JOAs. The JOA required that a party in Default (i.e. the '**Defaulting Party**') (as defined in the JOA): (i) loses the right to attend Operating Committee meetings or to vote on any matter before the Operating Committee; (ii) loses the right to its participating share of any hydrocarbons; and (iii) if the Defaulting Party does not remedy its Default after a period of time (being 45 days in this case), it can be compelled to withdraw from the JOA and the Oil Mining Lease (or relevant granting instrument). Although not set out in the decision, it seems from the text of the above provisions contained in the decision that the JOA was based on the old 1995 AIPN Model Form Operating Agreement.

A dispute arose between the parties concerning, broadly, the drilling of two development wells within the area covered by the Oil Mining Lease (the '**Development Wells**'). At an Operating Committee meeting on 5 October 2016, Pan Petroleum opposed draft resolutions relating to one of the Development Wells. In late 2016, Pan Petroleum refused to pay Cash Call(s) issued in respect of the Development Wells. It refused to do so on the basis that the drilling of the wells was premature. Further, that such operations required unanimous consent of the joint venture partners that had not been obtained (whereas the other parties to the JOA argued that a qualified majority was sufficient under the JOA). Accordingly, Pan Petroleum argued that any Cash Calls to the parties in respect of the Development Wells had not been issued in accordance with the JOA. However, because of its refusal to pay the Cash Call(s), on 21 October 2016 Pan Petroleum was issued with Default Notices (as defined in the JOA) requiring payment of the Cash Call(s), and further notices followed in November 2016.

Pan Petroleum applied to the Commercial Court for an interim injunction to prevent the non-Defaulting Parties from exercising any rights or remedies under the JOA.

In the period after the granting of the injunction, but before the interim injunction return date, the other JOA parties indicated that they proposed to proceed with the second Development Well. Budget proposals were circulated, which were opposed by Pan Petroleum on substantially the same grounds as it had objected to the first Development Well.

Three further Cash Calls, numbers 30, 31 and 32 were issued for payment on or before 27 December 2016. Cash Call 32 related in part to disputed Development Well expenses and was recalled and reissued on 6 March 2017. Upon non-payment of these Cash Calls, Default Notices were issued to Pan Petroleum on 9 January 2017.

Pan Petroleum was successful in its application for an interim injunction to restrain the non-Defaulting Parties from exercising any rights or remedies under the JOA in respect of the Development Wells. The decision granting the interim injunction has not been published, but much can be understood about its terms and significance from subsequent proceedings.

The interim injunction required:

> *"2. Up to and including the date specified […] the Defendants must not exercise or purport to exercise (by written notice or otherwise) in respect of the Aje-6 or Aje-7 development wells:*
>
> *2.1 any of the rights and/or remedies in Article 8.4 of the Joint Operating Agreement to vest, deem to vest, transfer, or deem to transfer for its own benefit or otherwise the Claimant's Entitlement and/or Participating Interest in the Joint Operating Agreement or Oil Mining Lease 113;*
>
> *2.2 any of the rights and/or remedies in Article 8.2 of the Joint Operating Agreement to exclude the Claimant from participating in, or voting at, meetings of the Operating Committee;*
>
> *2.3 any right of termination at law or other remedy which would deprive the Claimant of its Entitlement and/or Participating Interests in the Joint Operating Agreement or Oil Mining Lease 113."*

In January 2017, and three days after a further hearing at which the interim injunction was continued, a meeting of the Operating Committee was held, during which the Operating Committee passed various resolutions relating to operations in respect of the Development Wells. Pan Petroleum was not invited to participate at the meeting, and was treated as being excluded from voting due to being in Default for failing to pay Cash Calls 30 and 32 that did not relate to the Development Wells in dispute.

In February 2017, with a view to avoiding contempt proceedings, Pan Petroleum repeated its invitation to the other JOA parties to withdraw the resolutions. Those requests were rejected. Pan Petroleum therefore commenced contempt proceedings on 1 March 2017, seeking declarations that the purported resolutions were illegal, null and void as a matter of English law.

Commercial Court Decision

At the hearing, there was some debate as to the precise wording of the interim injunction, and whether the resolutions passed at the January 2017 Operating Committee meeting approved the *"financial calls and budgets for work on or with those [Development Wells], rather than the approval of the work itself"*. However, the Commercial Court was quick to find that the non-Defaulting Parties had breached the terms of the interim injunction and were in contempt of court.

The first, second and fourth defendants appealed against the decision to the Court of Appeal.

Court of Appeal Decision

The appeal was rejected by the Court of Appeal, which upheld the Commercial Court's finding of contempt of court for breach of a prohibitory interim injunction made in support of arbitration proceedings.

The Court of Appeal decided that as a matter of construction it was clear that the overall wording: *"the Defendants must not exercise or purport to exercise (by written notice or otherwise) in respect of the Aje-6 or Aje-7 development wells …any of the rights and/or remedies in Article 8.2 of the Joint Operating Agreement to exclude the Claimant from participating in, or voting at, meetings of the Operating Committee"* prohibited the appellants from doing what they purported to do on 23 January 2017: excluding Pan Petroleum from the Operating Committee on whatever basis and then passing resolutions in respect of the Development Wells.

The overall context and object of the injunction overwhelmingly supported that construction. From the time of the *ex parte* hearing onwards, Pan Petroleum was seeking relief to *"hold the ring"* pending the conclusion of the arbitration, not just to prevent the appellants from forcing its complete withdrawal from the project under Article 8.4, but also to prevent the appellants from excluding Pan Petroleum from the decision-making processes of the Operating Committee under Article 8.2, on whatever pretext or basis and then passing resolutions in respect of the Development Wells seeking to establish budgets and make Cash Calls.

The appellants' submission that the injunction should not be construed as protecting Pan Petroleum in respect of undisputed Cash Calls, because it could not in such a case demonstrate any cause of action entitling it to be on the Operating Committee, was misconceived. The merits of the underlying claim of Pan Petroleum were to be determined in the arbitration, not before the Commercial Court and, in any event, at best this point would go to the question of whether the injunction should have been made in as wide terms as it was (which was not the subject of the appeal), not to the issues of the correct construction of the injunction and whether the appellants were in contempt.

The Court of Appeal re-affirmed the principle that intent to breach a court order is not a requisite aspect in determining whether contempt of court is established, even where the actions of the proposed contemnor were informed by legal advice.

Comment

Whilst the Court of Appeal's decision provides an insight into how the English courts might approach the interpretation of the terms of an interim injunction, it will likely be of greater interest to those involved in the day-to-day management of oil and gas joint ventures where participants are not aligned on strategy or one party is allegedly in default.

In the current market, operators have found it more difficult to gain unanimity on approving work programmes and budgets, or extensions to work programmes and budgets. As such, cash calls appear to be more regularly unpaid or disputed than was the case in the past. Further, debates seem to abound concerning whether sums cash called are properly authorised by the joint venture under the JOA.

For any joint venture governed by JOAs following the AIPN Model Form (or the Oil and Gas UK Model Form), the obvious risk for a party that does not wish to pay a cash call is that the operator (or other participant) will exercise the remedies contained within the default provisions of the JOA, and as a 'Defaulting Party' it will be prevented from voting on future decisions and will eventually be excluded.

Conversely, the AIPN Model Form Operating Agreement and Oil and Gas UK Model Form are structured so as to allow a 'Defaulting Party' to be excluded swiftly, which allows the joint venture to continue operations in such a way as to ensure that the underlying obligations of the joint venture to third parties will be performed. The risk to the supposed non-Defaulting Parties is that any failure of the remedies mechanism to work in the time-periods envisaged risks gridlock and a failure of the joint venture's purpose, resulting in losses and liabilities for all parties.

Where London is the seat of arbitration, the English High Court has the power to grant interim injunctions in support of arbitration. In deciding whether to exercise its discretion to grant an interim injunction, the Commercial Court will consider: (i) whether there is a serious question to be tried; (ii) whether damages would be an adequate remedy; (iii) who the balance of convenience favours; and (iv) any special factors. In this regard, although the actual judgment where the interim injunction was granted is not available, the decision nevertheless shows that the Commercial Court is willing to intervene, at least for a short period, in order to preserve the *status quo*.

Now that the Court of Appeal has confirmed the approach taken by the Commercial Court at first instance, this decision could have a significant impact on the conduct of joint operations pending resolution of a dispute arising under a JOA. For example, while the injunction might prevent the non-Defaulting Parties from exercising any remedies to compel the Defaulting Party to withdraw from the joint venture, if the terms of the injunction are wide enough, they may assist by excluding a Defaulting Party for a period of time not envisaged by the JOA.

Further, the wide terms on which the injunction was granted might be a cause for concern for non-Defaulting parties – suggesting that if a disputed Cash Call can be identified, a party unwilling or unable to pay Cash Calls generally might seek temporary shelter from the courts pending the resolution of the 'disputed' Cash Calls. If this were to be the courts' practice, it could have the impact of frustrating the operation of the default provisions of most JOAs.

Judges: Gross LJ, Lewison LJ, and Flaux LJ

Production Sharing Agreements and Licences

The past twelve months have provided some further interesting decisions in relation to dealing with the rights/obligations under production sharing agreements ('**PSAs**') and licences. Amongst other things, the English courts have finally considered whether a UKCS licence is a contract. Also, interesting decisions have been rendered on aspects of international PSAs.

— In *R. (Benjamin Dean) v The Secretary of State for Business, Energy and Industrial Strategy* [2017] EWHC 1998 (Admin), the Administrative Court considered whether a UKCS licence was governed entirely by the statutory provisions or was a contract.

— In *Monde Petroleum SA v WesternZagros Ltd* [2018] EWCA Civ 25, the Court of Appeal provided guidance as to what the words *"fully operational and enforceable"* mean in the context of a PSA in Kurdistan (Iraq). In doing so, the Court of Appeal ventured into an area that is hotly contested in Iraq.

— In *Reliance Industries Ltd & Anor v The Union of India* [2018] EWHC 822 (Comm), the Commercial Court provided an interesting insight into the functioning of the remuneration provisions of an Indian PSA, specifically the complex relationship between cost recovery and profit oil.

UK Petroleum Licences: Contract or Regulation?

Summary

In *R. (Benjamin Dean) v The Secretary of State for Business, Energy and Industrial Strategy* [2017] EWHC 1998 (Admin), the Administrative Court considered an application by judicial review to quash a Deed of Variation, which extended the Initial Term of an onshore UK petroleum licence.

The decision contains useful clarification as to the contractual and regulatory considerations applicable to onshore and offshore licences, including: (i) whether a licence was governed entirely by the statutory provisions; (ii) if so, whether the Secretary of State for the Department of Business, Energy and Industrial Strategy ('**DBEIS**') had the power to vary a licence; and (iii) if so, whether DBEIS had the authority to enter into a Deed of Variation.

Facts

The case concerned an onshore Petroleum Exploration and Development Licence ('**PEDL 189**') in Cheshire, granted under section 3 of the Petroleum Act 1998 on 3 September 2008 to Engie, Ineos and Dart Energy (the '**Licence Holders**'), Dart Energy also being the operator. The licence had an Initial Term (an exploration phase, whereby the Work Programme and Budget agreed with DBEIS was to be performed) of six years on and from 1 July 2008. This was followed by a Second Term (within which a Field Development Plan was to be formulated and land rights acquired to conduct the development) of five years. The final term, the Production Period, was to last twenty years.

The initial Work Programme and Budget envisaged the exploitation of coal bed methane, but when the shale gas potential was realised, discussions were held between the Department for Energy and Climate Change (the predecessor of DBEIS) and the Licence Holders in respect of restructuring the term of the licence.

In 2013, the Initial Term was extended by a Deed of Variation to eight years. Expiry of the Initial Term was then due on 30 June 2016. The Second Term was reduced from five to three years. The Production Period and overall duration of the licence were unaffected.

Fracking was required to explore the shale gas potential further during the Initial Term. Protesters occupied the site, preventing work, between 2014 and 2016.

Due in part to this delay, the licence was again amended in 2016 by a Deed of Variation between the Licence Holders and DBEIS (the '**2016 Deed**'). The Initial Term was extended to ten years. The Second Term was reduced to one year. Again, the Production Period and overall duration of the licence were unaffected.

The Claimant was a parish councillor in the area and applied for judicial review of the 2016 Deed. Dart Energy appeared in the case as an Interested Party.

Arguments of the Parties

The Claimant argued that the licence was granted under the Petroleum Act 1998 and was governed entirely by that Act as a *"complete statutory code"*, which did not permit DBEIS to vary a licence once granted. In the alternative, the Claimant argued that DBEIS had no authority to vary the licence.

DBEIS (and Dart Energy) argued that the licence was contractual as it concerned the grant of proprietary rights. It was therefore variable by agreement in accordance with the usual contractual principles.

Decision

It was common ground between the parties that: (i) petroleum vests in the Crown, irrespective of land ownership (the Administrative Court referred to the leading judgment confirming this key principle: *Bocardo v Star Energy* [2010] UKSC 35); and (ii) labelling the licence as *"contractual"* or *"regulatory"* should not replace the correct legal analysis, which is to look at the substance and effect of the rights and obligations created by the licence, viewed objectively in the context of the legislation under which it was issued.

Nature of licence rights

The Administrative Court drew upon the history of mining leases, mining licences coupled with a grant and bare licences and noted the contrast between: (i) a right to carry away the minerals won, which conferred property in the minerals won; and (ii) a bare licence simply to search for minerals, which conferred upon the licensee no property in the minerals obtained.

It was held that a licence granted under section 3 of the Petroleum Act 1998 is an exclusive licence to search for, bore for and get petroleum. The licence also granted to the licensee rights of ownership over product once won. The licence therefore created private law rights.

A petroleum licence was *"essentially a property transaction, akin to a mining licence or a mining lease…more than simply a contractual agreement between two parties, it is a grant of an interest in land"* the terms of which were *"entirely consistent with a normal grant of property rights in a mining lease or a mining licence"*. In this respect, it affirmed the position in Halsbury's Laws (5th Ed) Vol 76 that *"since minerals are part of the land it follows that a lease can be granted of the surface of the land and the minerals below"*. As with mining leases and licences, the creation of the interest was achieved by the execution of a deed. The creation of a section 3(1) Petroleum Act 1998 licence by deed reflected the need for that formality when creating an interest in land. The use of the word *"grant"* in section 3(1) was indicative of an interest in land.

The interest in land was the exclusive right to *"explore"* and *"get"* petroleum. The petroleum became personal property, capable of sale to third parties, once *"won"*.

A grant of interest in land was subject to contract law principles in respect of the ability of parties to vary their agreement. A consensual variation was an instance of the *"normal dealings within a commercial relationship created by a contractual deed of licence"*. The fact that a licence was granted under a statutory provision did not alter that analysis, unless such a right was excluded or modified either by the statute or the licence itself.

The Right to Vary the Licence

Having assessed the nature of the licence rights, the Administrative Court concluded that neither the legislation, nor the terms of the licence itself, prohibited the variation in the 2016 Deed. As such, the variation was lawful.

The Administrative Court nonetheless considered whether, assuming the licence was governed entirely by the statutory code, the 2016 Deed fell within the incidental powers of the Crown and DBEIS under the legislation – i.e. whether the 2016 Deed was *ultra vires* (i.e. outside of legal authority).

The Administrative Court noted that the doctrine of *ultra vires* required it to assess what ought to be reasonably and fairly regarded as incidental to, or consequential upon, those things which the legislature has authorised. The licensing regime under the Petroleum Act 1998 had the objective of encouraging applications for licences by enterprises prepared to take on the substantial risks involved in exploring for and getting petroleum, so as to promote and maximise the economic recovery of a valuable UK resource. It could be said that there was a public interest argument in favour of the flexibility afforded by recognising the power of DBEIS to vary a licence by agreement with the licensee.

It was held that, even if licences were governed solely by a statutory code, there was nonetheless an implicit or incidental power to vary a licence subsequently by agreement. Again, it was noted that this implicit power could be expressly excluded by the legislation, but this was not the case.

The Authority of DBEIS

The Administrative Court gave short shrift to the final argument by the Claimant, which was that DBEIS only had authority from the Crown to enter into the licence, not to vary it. The Administrative Court noted that the Petroleum Act 1998 gave substantial authority to DBEIS beyond simply executing the licence, for example: setting the consideration or terms of the licence. It was a settled principle that, when dealing with a lease or similar property-related transaction, there was no distinction between Her Majesty in her public capacity, the Crown or the Secretary of State responsible for exercising governmental functions. There was no legal requirement for the 2016 Deed to state that DBEIS was acting for and on behalf of the Crown.

It was entirely consistent with the statutory scheme that, whilst acting on behalf of the Crown, DBEIS should be able to agree variations in the terms of the licence.

Further Matters decided by the Administrative Court

The decision clarified the impact of previous case law on the question of the legal nature of petroleum licences. Some practitioners may be familiar with the case of *Inland Revenue Commissioners v Mobil North Sea Ltd* [1986] 1 WLR 296 ('**Mobil**'), where it was held that a petroleum licence did not fall within the meaning of *"a contract"* as used in section 111(7) of the Finance Act 1981.

However, the Administrative Court reached the *"clear conclusion"* that Mobil was *"not in point"* and so the Administrative Court was not bound to follow the decision. Mobil turned on a principle that not every document containing contractual obligations could properly be described as a *"contract" "for the purposes of a particular statutory scheme"*, even though it is otherwise contractual. Mobil had *"nothing to do with the question whether a petroleum licence can properly be described under the general law as a contract and thus capable of consensual variation"*.

The judgment also confirms that a right to vary a licence is not in breach of EU law (i.e. the 1994 Hydrocarbons Licensing Directive (94/22/EC)). EU law did not seek to control a Member State's decision to subdivide the overall duration of a licence into constituent parts (in this case, Initial Term, Second Term and Production Period). Nor did it prohibit a decision to allow those phases to be increased or decreased – *a fortiori* when the overall duration of the licence was unaffected.

Comment

The decision makes it clear that, whatever its nature, a petroleum licence is an instrument capable of amendment by the agreement of the parties, subject to any restriction on that ability that might be expressly set out in legislation or the terms of the licence itself.

The Administrative Court took evidence from Mr. Simon Toole, former Director of Licensing and Legal at the Oil and Gas Authority. The Administrative Court took note of the vital role flexibility can play in the conduct of petroleum projects, both onshore and offshore. It was in the national interest for DBEIS to be able to react to the changes of circumstance that can take place during the term of a licence by agreeing to variations – even substantial variations. There would be an adverse effect on market confidence and interest in opportunities for exploration if the parties could not legally agree variations of the licence.

The decision will provide some comfort to onshore and offshore licensees. The Administrative Court was aware of the need to avoid significant disruption to the operation of the licensing regime.

If it were not possible to vary a licence by a deed of variation, it was estimated that 121 onshore licences, including PEDL 189, would have no other mechanism available to vary Work Programmes or the duration of the Initial or Second Terms. A further 79 onshore licences would have no other mechanism available to vary a Work Programme or other clause.

In addition, as at 3 February 2017, there were 530 offshore licences extant. Although the decision was specifically concerned with an onshore licence, much of the analysis is equally applicable to offshore licences (albeit the courts would not categorise these as *"an interest in land"* to the same extent, given the UK's rights at international law extend only to the rights to search, bore for and get petroleum, with no ownership rights in the petroleum itself until won).

Indeed, the Administrative Court noted that the problems for offshore licensees – and the consequent need for flexibility – would be much greater, as their costs are typically an order of magnitude greater than those onshore. The fact that there were certain consent stages in an offshore licence, which must satisfy further regulatory requirements before certain works can begin (e.g. Environmental Impact Assessments), did not alter the nature of the grant by the Crown of exclusive property rights and the incidental power to amend the licence by agreement. The only restriction was that no agreed variation to the licence could override those further regulatory requirements.

Judge: Holgate J

PSAs: meaning of 'operational and enforceable'

In *Monde Petroleum SA v WesternZagros Ltd* [2018] EWCA Civ 25, the Court of Appeal has provided guidance as to what the words *"fully operational and enforceable"* in an agreement might mean in the context of a production sharing agreement in Kurdistan (Iraq). In particular, the Court of Appeal considered whether such an agreement may be considered fully operational and enforceable without ratification by the Federal Government of Iraq. In doing so, the Court of Appeal ventured into an area that is hotly contested in Iraq.

Facts

In early 2006, WesternZagros Ltd ('**WZL**'), sought to negotiate and thereafter enter into an Exploration and Production Sharing Agreement ('**PSA**') with the Kurdistan Regional Government ('**KRG**'). Following an impasse in negotiations, WZL was directed to Mr Yasser Al-Fekaiki, sole Director of Monde Petroleum SA ('**Monde**'), who had family connections within the KRG, to assist in lobbying for WZL support within the KRG.

Subsequently, WZL and Monde entered into a Consultancy Services Agreement ('**CSA**'). The CSA allowed for monthly payments together with success fees which could be triggered by achieving 'milestones' linked to the PSA Seismic Program and ratification of the PSA (in the form of a Confirmation and Support Letter of the Government of the Republic of Iraq) (the '**Iraqi Federal Government**'). If ratification was achieved, and subject to the milestones being reached, the PSA gave Monde the right to acquire a 3% working interest in the PSA.

The termination provisions of the CSA stated:

> *"10.2… this Agreement shall continue if the [PSA] is executed within 4 months from the date hereof or, if the [PSA] is not executed, at the election of [WZL], provided that this Agreement and the option contemplated in Schedule "C" (the Option) may be terminated by [WZL] upon thirty days' notice to [Monde] should the [PSA] not become fully operational and enforceable within six months from the date hereof. If this Agreement is continued as set out above, on the 1 year anniversary of this Agreement it shall terminate with respect to the payments contemplated in Schedule "B", unless mutually extended for 1 year terms.*
>
> *10.3 Notwithstanding the provisions of Section 10.1 and 10.2 above, this Agreement and the Option may be terminated:*

(i) by [WZL] upon thirty days' advance written notice to [Monde] if it becomes manifestly apparent that an operational and enforceable [PSA] in form and on terms acceptable to [WZL] cannot be concluded;

(ii) by either party immediately in the event the other party commits a material breach of this Agreement which remains uncured after the period for curing specified in the notice of the breach has expired;

(iii) by mutual written agreement of the parties;

(iv) by election of [WZL] on the termination of the [PSA]; or

(v) by [WZL] if it is manifestly apparent that achievement of the milestones set out in Schedule "B" are being achieved primarily as a result of activities of third parties."

The final sentence of Schedule B stated that *"the Option shall only vest upon the events described in (c) above having occurred"*.

In May 2006, a PSA was signed between WZL and the KRG (less than 2 weeks after the execution of the Monde CSA). However, at that stage the PSA had yet to be ratified. Prior to or during the PSA negotiations, Monde (unbeknown to WZL) had formed an arrangement with Bafel Talabani ('**Bafel**'), son of the President of Iraq and a Commander of the KRG's Counter Terrorism Group, who had been involved in the PSA negotiations.

In March 2007, after concerns regarding performance and rumours of a 'fall from grace' in the region, WZL faxed a notice of termination to Monde ('**Notice of Termination**'). However, the Notice of Termination did not provide the requisite 30 day notice period in accordance with the termination provisions of the CSA. In April 2007, a draft termination agreement was sent to Monde ('**Termination Agreement**'). Monde refused to sign.

There was then a change in relationship between Bafel and Monde. Bafel made a series of telephone calls to Mr Al-Fekaiki (sole director of Monde). Monde argued that Bafel advised that if it signed the Termination Agreement it would benefit through a new agreement between WZL and a politically controlled entity under which Monde would receive payment indirectly and would be no worse off than if the CSA had continued. Monde also argued that Bafel promised that it would receive an immediate payment of all outstanding sums due to Monde by WZL if it signed the Termination Agreement. Four days after Monde's initial refusal, Mr Al-Fekaiki signed the Termination Agreement, on behalf of Monde.

Commercial Court Decision

In the Commercial Court Monde claimed that its signing of the Termination Agreement was procured by misrepresentations made by Bafel on WZL's behalf and/or economic duress. On that basis, Monde sought to set aside the Termination Agreement and/or to claim damages, and asserted that the Notice of Termination was invalid and that, by serving it, WZL committed a repudiatory breach of the CSA, entitling Monde to substantial damages for the loss of its rights under the CSA, including its 3% option.

WZL denied making any misrepresentations or exercising any duress to procure the Termination Agreement. WZL also said that, even if Monde were to succeed in its claims relating to the Termination Agreement, Monde would be unable to prove any substantial loss because, on WZL's case, the Termination Notice was itself effective to bring the CSA to an end, or (if that were wrong) WZL would have been entitled to serve a further such notice. In either event, no further payments would have become due to Monde under the CSA, and Monde's 3% option would never have vested.

The Commercial Court decided that the Termination Agreement had been procured by misrepresentation but that Monde could not prove any loss following from that because WZL was, at all times, entitled to terminate the CSA on notice thus ensuring that Monde would never have been in the position to exercise its 3% option.

Monde appealed against the decision to the Court of Appeal.

Issues before the Court of Appeal

Permission to appeal was restricted to the following two issues:

- whether the phrase *"fully operational and enforceable"* in Clause 10.2 of the CSA required only that the KRG ratify the PSA or whether all the milestones had to be passed, including the receipt of a signed letter from the Iraqi Federal Government; and
- whether, in the event that WZL became entitled to serve a 30 day notice pursuant to the proviso in Clause 10.2, such notice had to be given immediately or could be given at any time while there was no *"fully operational and enforceable"* PSA.

Court of Appeal Decision

The Court of Appeal unanimously upheld the Commercial Court's ruling.

In relation to the first question, the Court of Appeal decided that the phrase *"fully operational and enforceable"* had to have the same meaning throughout the CSA. Monde's Iraqi law expert had accepted that the KRG and the Iraqi Federal Government had differences of view as to the extent of the KRG's authority to grant exploration and production agreements in relation to Kurdistan and whether the KRG was entitled or had the authority to enter into such agreements. There was also uncertainty as to whether the KRG owned the oil fields in Kurdistan at all and therefore whether the PSA had been ratified *"appropriately to the acceptance of all the political players"*. As such, the Court of Appeal found that mere ratification of the PSA by the KRG did not render the PSA *"fully operational and enforceable"*. For that to be the case both the KRG and the Iraqi Federal Government had to be *"onside"*.

It was entirely legitimate for the Commercial Court to accept, from the rival interpretations, the interpretation that it considered made commercial sense and was *"rooted fairly and squarely, in the commercial and political background which existed at the time when the contract was made"*.

In response to the second question, the Court of Appeal decided that this was a *"hopeless contention"* and found that WZL had the right to terminate the CSA at a time of its own choosing. Clause 10.2 provided that WZL could terminate *"should the [PSA] not become fully operational and enforceable within six months from the date of the [PSA]"*. No requirement of immediacy was expressed in the contract terms and there was no reason for such immediacy to be implied. The effect of such an argument would be that if notice was not immediately given, WZL would be locked into the CSA until such time as it could show within the terms of Clause 10.3 that it had become *"manifestly apparent that an operational and enforceable [PSA] ... [could not] be concluded"*. The Court of Appeal considered this position to be *"highly un-commercial"*.

Comment

In Iraq, disagreements persist as to the KRG's right to award PSAs without the ratification or authority of the Iraqi Federal Government. The KRG claims competency to award oil interests. The Iraqi Federal Government considers such award to be a federal issue and within the Iraqi Federal Government competency. As such, an uneasy *de facto* state of affairs has come to exist whereby the KRG PSAs exist and exports of oil emanating from Kurdistan continue, but without the authority of the Iraqi Federal Government. Further, oil companies that continue to own the KRG PSA interests are routinely disqualified from owning oil interests in the rest of Iraq by the Iraqi Federal Government. It follows that whether the KRG PSAs are *"fully operational and enforceable"* is a far from straightforward question. The KRG would doubtless say that its PSAs are fully operational and enforceable. The Iraqi Federal Government would not agree.

Whilst the Court of Appeal affirmed that it will not allow commercial common sense and surrounding circumstances to be invoked to undervalue the importance of the language of the provision to be construed, it also confirmed that it would undertake a robust analysis of the circumstances to ensure that any commercial contract is construed against its commercial background. In construing a contract to be performed in Iraq, this included the political and legal background relevant to Iraq.

The Commercial Court and the Court of Appeal reached the conclusion that in the CSA *"fully operational and enforceable"* meant that Iraqi Federal Government approval was required. However, the conclusions of the Court of Appeal are arguably specific to the facts of the CSA. The Court of Appeal did not make any decision as to the proper interpretation of the legal position in Iraq.

The Court of Appeal's decision is a salutary reminder that whilst words such as *"fully operational and enforceable"* may be susceptible to only one interpretation in some jurisdictions, in other jurisdictions issues over competency to award/ratify or international boundaries might render such words open to multiple interpretations.

Judges: Longmore LJ, Hallett LJ, Singh LJ

Profit-sharing under PSAs

In *Reliance Industries Ltd & Anor v The Union of India* [2018] EWHC 822 (Comm), the Commercial Court provided an interesting insight into the functioning of the remuneration provisions of an Indian production sharing agreement, specifically the complex relationship between cost recovery and profit oil. The decision of the Commercial Court sheds light into an arbitral award that would have, absent an appeal, remained confidential in its reasoning.

Facts

On 22 December 1994, the Union of India ('**India**') granted Reliance Industries Limited and BG Exploration and Production India Limited (which shall together be referred to as the '**Contractor**') two production sharing agreements (the '**PSAs**') for the exclusive right to exploit petroleum resources in the Tapti gas field and Panna Mukta oil field off the west coast of India. The PSAs were in similar, but not identical, terms.

The PSAs, which were governed by Indian Law, contained a number of terms:

— Article 7.3(a) stated that the Contractor *"shall: … except as otherwise expressly provided on [the PSAs], conduct all Petroleum Operations at its sole risk, cost and expense and provide all funds necessary for the conduct of Petroleum Operations…"*;

— Article 5.6(a) required the 'Management Committee' to approve work programmes to be carried out under the PSAs; and

— Article 13.1.2 concerned the Contractor's initial programme or plan for development (as opposed to exploration or production), which was to be produced by the Contractor and was subject to Management Committee approval.

The PSA also included a number of provisions in relation to cost recovery and profit sharing:

— Article 1.29 defined *"Development Costs"* as *"those costs and expenditures incurred in carrying out Development Operations, as classified and defined in Section 2 of the Accounting Procedure and allowed to be recovered in terms of Section 3 thereof"*.

— Article 13 entitled the Contractor to recover its costs from the total volume of petroleum produced and saved from the fields in each financial year. Article 13.1.2 limited the extent to which *"Development Costs"* may be recovered, and provided that the recovery of *"Development Costs"* incurred in relation to each of the PSAs was to be capped by a specified amount (referred to as the '**Cost Recovery Limit**', or '**CRL**'). Development Costs incurred by the Contractor in excess of the CRL was to be borne by the Contractor. If, in certain specified circumstances, the CRL was exceeded, it could be increased to reflect those circumstances, either by the Management Committee or, in default of agreement by the Management Committee, by an arbitral tribunal (Articles 13.1.4(c) and 13.1.5).

— Article 1.24 defined *"Cost Petroleum"* as the petroleum available to the Contractor for cost recovery. *"Profit Petroleum"* was defined under Article 1.69 as petroleum produced in excess of that available for cost recovery.

— Article 14 provided that *"Profit Petroleum"* was to be shared between the Contractor and India in accordance with a formula set out in Appendix D to the PSAs. In simple terms, the formula operated in such a way that the more profitable the petroleum produced was (i.e. the more income exceeds costs), the greater India's share of the profit. One component of the formula in order to determine costs to be deducted is *"Development Costs"*.

A dispute arose over the definition of *"Development Costs"* for the purpose of the profit sharing formula in Appendix D.

The Contractor argued that *"Development Costs"* should be interpreted to include all Development Costs as defined in Article 1.29. India argued that for the purpose of the formula, *"Development Costs"* meant only those Development Costs falling below the cap of the CRL.

The Arbitration Award

The arbitral tribunal found in India's favour, which had the effect of decreasing the cost deduction to be applied and thereby increasing the profitable production and increasing India's share of profits.

In making its decision, the arbitral tribunal primarily considered three factors:

— It followed from the definition of *"Profit Petroleum"* in Article 1.69 that all petroleum which is not Cost Petroleum is Profit Petroleum that is available for sharing. Accordingly, the arbitral tribunal considered that petroleum that is not Cost Petroleum is profit, and cannot be used to recover costs.

— The arbitral tribunal considered that, on a proper construction of Article 13, recovery under this article was the only means for the Contractor to recover costs. Profit Petroleum cannot, therefore, also be used to recover costs by function of the formula.

— The arbitral tribunal also considered that on a proper construction of Article 7.3 (referenced above), the Contractor was only entitled to recover expenses under the provisions in the PSAs. The PSAs provided, at Article 13, for the recovery of *"Development Costs"* only to the extent that they fell beneath the CRL cap. Therefore, the Contractor should not be able to use the formula referred to in Article 14 to recover Development Costs otherwise unrecoverable under Article 13.

The arbitral tribunal concluded that it simply cannot be right for the Contractor to effectively be able to recover otherwise irrecoverable Development Costs (i.e. Development Costs in excess of the CRL cap) in the form of Profit Petroleum, in particular in circumstances where the *"obvious intention"* of Article 13 was to cap recovery of Development Costs. Further, the Contractor's interpretation would produce an outcome *"which is startling from a commercial perspective"*, as it would incentivise the Contractor to increase its Development Costs, which would have the effect of increasing the percentage share of Profit Petroleum the Contractor received. Again, the arbitral tribunal considered that this could not have been intended.

Commercial Court – Challenge to the Arbitral Award

The arbitral award became public as the Contractor challenged it before the English courts on nine grounds pursuant to sections 67, 68 and 69 of the Arbitration Act 1996 (the '**Act**').

In relation to the above issue, the Contractor argued that the arbitral tribunal reached a conclusion based on an entirely new point which had not been explored by the arbitral tribunal with the parties at any stage. It claimed that this was seriously unfair and led to a serious procedural irregularity under section 68 of the Act.

The Commercial Court dismissed the challenge. It decided that the arbitral tribunal was not obliged to put to the parties all aspects of its analysis in support of its conclusion; it was sufficient if all *"essential building blocks"* of the arbitral tribunal's reasoning were *"in play"* in the arbitration.

Comment

While the Commercial Court's decision is a useful reminder of how difficult it is to raise a challenge under section 68 of the Act, what happened in the underlying arbitration is perhaps of greater interest to oil and gas lawyers.

This decision highlights the often complex nature of remuneration provisions under PSAs. In this case, the relationship between Development Costs and Profit Petroleum was capable of more than one interpretation. On a literal reading of the words of the PSAs, it is arguable that the Contractor had a strong case. The definition of Development Costs did not include the CRL cap, which was contained elsewhere in the PSAs. As a consequence, the inclusion of the defined term *"Development Costs"* in the calculation of Profit Petroleum did not import the cap. It might be said that not just is that the literal meaning of the PSAs, but that it is the natural and ordinary meaning. Further, properly read, the relevant clause is not capable of alternative interpretation.

However, the arbitral tribunal looked beyond such approach. It read the PSAs as a whole and focused on the commercial consequences of the rival interpretations. The arbitral tribunal was clearly uncomfortable with a perception whereby (i) the Contractor's interpretation may have allowed it to recover costs indirectly that the cap prohibited it from receiving directly and (ii) would have had the further consequence of shifting the costs upwards, so as to increase the Contractor's profit share in the event of its own inefficiency in a manner that would seem commercially illogical.

The remuneration provisions of PSAs are notoriously complex and careful thought should be given to the potential for rival interpretations of formula when drafting or modelling the commercial consequences of clauses.

Arbitral Tribunal: Christopher Lau SC (Chairman), Peter Leaver QC and Justice B Sudershan Reddy

Judge: Popplewell J

Oil and Gas Sale and Purchase Agreements

The disruption in the oil price has ensured that commodity sale and purchase agreements have continued to result in a steady stream of English court decisions.

— In *Glencore Energy UK Ltd v OMV Supply & Trading Ltd* [2018] EWHC 895 (Comm), the Commercial Court decided that an exchange of emails between parties to an existing crude oil sales agreement was capable of giving rise to a separate implied contract entitling the seller to additional sums for demurrage that were not catered for in the crude oil sales contract.

— In *Trafigura Beheer BV v Renbrandt Ltd* [2017] EWHC 3100 (Comm), the Commercial Court dismissed a belated attempt to challenge the quality of a shipment of gasoil outside the prescribed time and in the face of a conclusive evidence clause. The decision reinforces the principle that the English courts will not permit parties to circumvent contractually agreed processes concerning the measurement of quality.

Implied contract for demurrage outside BP Terms

In *Glencore Energy UK Ltd v OMV Supply & Trading Ltd* [2018] EWHC 895 (Comm) the Commercial Court decided that an exchange of emails between parties to an existing crude oil sales agreement was capable of giving rise to a separate implied contract. The result of that implied contract was that the seller was entitled to payment of additional sums for demurrage that were not catered for in the crude oil sales contract. As the crude oil sales contract incorporated the BP Oil International Limited's General Terms and Conditions for Sales and Purchases of Crude Oil it will be of wider interest.

Facts

Glencore Energy UK Ltd (the '**Seller**'), claimed compensation from OMV Supply & Trading Ltd (the '**Buyer**') for time spent by the vessel waiting offshore for a berth to become available at the discharge port.

The parties had entered into a contract for the sale and purchase of the oil, which was to be loaded in Novorossiysk, Russia, and discharged in Trieste, Italy (the '**Contract**'). The Contract incorporated the 2007 BP Oil International Limited's General Terms and Conditions for Sales and Purchases of Crude Oil (the '**BP Terms**'). Delivery was to be on a cost and freight ('**CFR**') basis. There was express provision for laytime and demurrage:

> ***Laytime:*** *"Laytime allowed at disport shall be 36 hours, commencing 6 hours after tendering of notice of readiness or upon commencement of discharge, whichever occurs first…"*
>
> ***Demurrage:*** *"…for all time exceeding the allowed laytime, Buyer shall pay demurrage to Seller in accordance with the actual charterparty rate. Any claim for demurrage to be received latest 90 days from completion of discharge otherwise it will be deemed to have been waived…"*

The oil was carried on a vessel chartered by the Seller. The charterparty was based on the BPVOY4 form, as modified, and contained a time limit for demurrage claims. The Buyer informed the Seller, through two emails, that there was congestion in Trieste and asked the Seller to hold the vessel offshore to await further instructions. The Buyer asked the Seller to have the master tender a notice of readiness upon arrival at the waiting area, and then again on arrival at Trieste, and that the notices should indicate the on-board vessel quantity survey of bunkers used during the waiting period, together with details of the demurrage rate agreed with the vessel owner.

The vessel arrived at the waiting area and remained there for 24 days before discharging its cargo at Trieste. More than 90 days later, the Seller claimed the vessel's waiting time as detention calculated at the contractual demurrage rate, plus the cost of the bunkers used during the waiting period. The Buyer rejected the claim on the basis that it was a demurrage claim under the Contract and was time-barred.

Arguments of the Parties

The Buyer argued:

— the waiting time fell to be treated as part of the laytime and demurrage calculation under the Contract; and

— alternatively, the Seller's agreement to hold the vessel offshore impliedly varied the Contract so as to make laytime run from the notice of readiness issued on arrival at the waiting area, with demurrage following automatically.

The Seller argued that the demurrage clause did not apply, but what applied instead was an implied contract, which came into being as a result of the Seller accepting the Buyer's request in its two emails that the vessel wait for a berth at Trieste. It was a term of that implied contract that such waiting time be paid at the demurrage rate, as well as for the cost of bunkers consumed.

Decision

The Commercial Court decided that the Seller was entitled to compensation for the services it provided to the Buyer at the demurrage rate for the days the vessel spent at the waiting area, and for the bunkers consumed during that period.

The Commercial Court analysed the application of the Contract and the arguments as to implication.

Scope of the Contract
The terms of the Contract did not apply to what happened:

— It would be *"wrong to regard the extra contractual services as though they had been performed to any extent under the contract, for the simple reason they were not"*.

— The only provision that expressly addressed waiting time was contained in the BPVOY4 form, which was not part of the Contract (it was a part of the charterparty and thus irrelevant), and, in any event, that clause did not refer to the service of a notice of readiness.

— Under the BP Terms, the Contract defined laytime as the time allowed for loading and unloading (*"at disport"*), and therefore did not contemplate that laytime could run in the middle of the carrying voyage. (No discharging operations were performed at the waiting position and the Seller's claim was for detention and not demurrage.)

— The notice of readiness issued on arrival at the waiting area did not bring the demurrage provisions into effect. The BP Terms defined a notice of readiness as a notice to load or discharge given by the master to the Seller at the loading terminal, or to the Buyer at the discharge port. The definition did not apply to a waiting period in which there was neither loading nor unloading.

— Under the BP Terms, the 36 hour period for the discharge of the oil began six hours after the tender of a notice of readiness, or on commencement of discharge, whichever was the earlier. The notice issued upon arrival at the waiting area could therefore not be a notice of readiness under the Contract.

— The Buyer could not explain how time was stopped when the vessel left the waiting area and then commenced again on arrival at Trieste. Nor could it explain how a new notice could be issued on arrival at Trieste when the Contract contemplated one notice (it did not provide for a second notice).

Implied Variation
The Buyer's argument that there was an implied variation to the Contract involved the substantial re-writing of the laytime and demurrage clauses in the Contract (and the BP Terms). Such significant amendments were not necessary to give business efficacy to the parties' agreement, and it was *"unlikely that someone in [the Seller's] position would have agreed to some of the variations consequent on [the Buyer's] analysis"*.

Implied Contract
The Seller's agreement to the Buyer's requests that the vessel be held offshore created an implied contract for 'delay by agreement', arising when the vessel arrived at the waiting area. It was unrealistic to treat the delay as a breach of contract and the Contract did not apply to the facts. An implied contract was necessary to give business reality to the transaction because, without it, the Seller would not be paid for the waiting time.

The implied contract provided that the vessel would wait in the waiting area for further instructions, and the Seller would be compensated for holding it there. The Buyer's request for details about the demurrage rate and the Seller's provision of those details led to that rate becoming the implied quantification of the Seller's claim. It was a fair commercial rate and met the standard of reasonableness.

Furthermore, the Buyer's request that the master record the bunkers used during the wait evidenced a further implied term that it would pay for those bunkers. In the Commercial Court's words: *"Why else should [the Buyer] request that bunker records be kept, except that a reasonable person knowledgeable about this trade would expect that a claim for bunkers would follow the request for the vessel to wait?"*.

The Seller was therefore entitled to compensation for holding the vessel in the waiting area, calculated at the demurrage rate, plus the cost of the bunkers used during that period.

Comment

The decision of the Commercial Court can be contrasted with the recent decision of the Commercial Court in *Lukoil Asia Pacific Pty Ltd v Ocean Tankers (Pte) Limited (Ocean Neptune)* [2018] EWHC 163 (Comm), where it was held that a claim by a vessel owner concerning time *"waiting on orders"* was a claim for *"demurrage"* and contractually time barred. In this connection, it is significant that the BP Terms reviewed by the Commercial Court governed the sale of crude oil (between oil companies), whereas the terms reviewed by the Commercial Court in *Lukoil v Ocean Tankers* were from the Exxonvoy 2005 standard (as amended) which, like the BPVOY4 standard, governs charterparties (between an oil company and a vessel owner), and so contains more detailed provisions on the application of demurrage.

The case joins a growing list of authority that payment for detention is typically paid at the demurrage rate (but that this does not constitute payment as demurrage).

It would seem that English law remains reticent to find that a commercial party has implicitly provided services for free outside its contractual obligations to do so; it is not what commercial parties would expect. The Buyer had sought to counter the Seller's implied contract argument on the basis that the courts only imply a contract when it is necessary to do so (*Baird Textile Holdings Ltd v Marks & Spencer plc* [2001] EWCA Civ 274, paragraphs [17]-[21]), and will not find one to remunerate a party if the situation is already covered by an express contract (*Steven v Bromley* [1919] 2 KB 722, 727).

However, this argument was rejected by the Commercial Court. The key point was that without an implied contract, the Seller would not have been paid for its services since the express provisions of the Contract for remuneration by demurrage did not apply, nor was there any agreement to vary the Contract's terms.

The Commercial Court's judgment also demonstrates that the words and conduct of parties to existing contractual relationships are capable of giving rise to express or implied contracts. This is particularly true where a party has acted upon what was agreed to its financial detriment. Care must be taken when commercial parties reach an alternative arrangement during the course of contractual performance. The Buyer's two emails requesting that the vessel wait outside Trieste were very short. The fact that such an arrangement was reached via the familiar medium of emails (as opposed to a formally agreed document negotiated by lawyers) did not, in and of itself, detract from its status as a separate and enforceable English law contract.

Judge: Sir Ross Cranston

Off-spec deliveries – upholding the contractual mechanism

In *Trafigura Beheer BV v Renbrandt Ltd* [2017] EWHC 3100 (Comm), the Commercial Court provided some comfort to purchasers and sellers that are seeking to rely on conclusive evidence clauses as to quality. The Commercial Court swiftly dismissed a belated attempt to challenge the quality of a shipment of gasoil outside the prescribed time and in the face of a conclusive evidence clause. The decision reinforces that the English courts will not permit parties to circumvent contractually agreed processes concerning the measurement of quality.

Facts

Trafigura Beheer BV (the '**Seller**') entered into a contract with Renbrandt Ltd (the '**Purchaser**') dated 4 August 2008 which, following variation, required the delivery of 10,000 mt of gasoil, plus or minus 10% at the Seller's option, by way of ship to ship transfer off the coast of Benin in October 2008 with delivery on free on board ('**FOB**') terms.

The clauses of the contract relevant to the dispute were, as noted by the Commercial Court, not particularly well drafted but contained express provisions in relation to (paraphrasing):

- quality – stated to be *"Gasoil 0.3% sulphur"*;
- restriction on quality – no warranty was given in relation to quality, fitness or suitability of the product and merchantability extending beyond the descriptions and specifications in the contract;
- quantity and quality inspection – determination to be made by an independent inspector as to the:
  - quantity of the product at the load port using the average of the discharge of the mother vessel and daughter vessel received quantities; and
  - quality of the product at the time of loading on the mother vessel, with such determination to be final and binding save for fraud or manifest error (but giving the Purchaser a 5-day challenge period as to quantity or quality from the date of the bill of lading); and
- governing law – the *"English High Courts in London"* were given exclusive jurisdiction and the contract was to be governed by and construed in accordance with English law (along with a somewhat confused arbitration clause).

The Seller delivered approximately 9,865.69 mt of gasoil to the Purchaser in early October 2008 as evidenced by two bills of lading. Upon loading, the gasoil was tested, and a certificate of quality was issued by Saybolt Nederland BV confirming that the sulphur content of the gasoil was on-specification at 0.261%. No claim was submitted by the Purchaser in respect of the quality of the gasoil within the contractual five day period from the date of the bill of lading.

Perhaps relying on the *"fraud or manifest error"* exclusion in the contract (this is not clear from the judgement), the Purchaser filed a petition on 10 June 2009 with the Nigerian Economic and Financial Crimes Commission (the '**EFCC**'), contending that the gasoil was *"off-spec"* and contaminated with other cheaper cargoes. This petition was, however, withdrawn on 4 June 2010. A further petition was then filed by the Purchaser with the EFCC on 20 September 2016 in relation to the same matter leading to the Seller commencing legal proceedings against the Purchaser in Nigeria for maliciously filing the second petition. The Purchaser was, at the time of the hearing before the English courts, defending the Seller's legal proceedings in Nigeria on the basis that the contract submitted disputes to the exclusive jurisdiction of the English courts and that proceedings had already been raised in England.

The Seller sought a declaration, *inter alia*, that the cargo was not off-spec and applied for summary judgment against the Purchaser.

Decision

The Purchaser attempted to resist the application for summary judgment by the Seller on a number of grounds, including:

- the contract required this dispute to be resolved by arbitration;
- the Purchaser did have a real prospect of success in defending the claim; and
- the declaratory relief sought by the Seller being time barred.

Arbitration clause
The Commercial Court decided that the dispute resolution clause was a poorly drafted hybrid jurisdiction clause. The first paragraph provided for all disputes to be submitted to the exclusive jurisdiction of the High Court in London. The second provided that arbitration shall be claimed within 5 days from the bill of lading date failing which the claim shall be deemed waived and absolutely barred without recourse to litigation and arbitration (with a carve out for claims and disputes in respect of demurrage, port costs, shifting, freight differential, heating and/or AWRP).

The principal function of the arbitration clause was to address any Purchaser claims as to quantity and quality. It did not apply to a claim for a declaration of non-liability which could only sensibly be made after a claim has been made against the Seller and which, in this case, was only made several years after the cause of action allegedly arose.

If the Purchaser was correct then the Seller would have no contractual remedy in circumstances where the Purchaser brought a claim against the Seller which is both out of time and in breach of the jurisdiction clause. That would be a commercially absurd result.

Prospect of success
The Commercial Court held that the Purchaser had no reasonable prospect of successfully defending the claim, as:

- First, the cargo was on-specification. This was confirmed by the certificate of quality, which confirmed that the cargo had a sulphur content of less than 0.3% and therefore complied with the only express warranty given by the Seller as to the quality of the cargo. Pursuant to Clause 14 of the contract, the certificate of quality was final and binding on the parties. The purpose of a conclusive evidence clause such as this is to avoid disputes as to quality and to achieve finality once a proper and independent certificate of inspection has been issued (see e.g. *Toepfer v Continental Grain* [1974] 1 Lloyd's Rep 11);
- Second, the Purchaser did not submit a claim in respect of quality within 5 days. There is a vague assertion that it did so in the Nigerian proceedings, but no evidence in support was produced. It follows that even if there had been any basis for making a claim in respect of the quality of the cargo, that claim had been waived and was absolutely barred; and
- Third, any claim was time barred by reason of Section 5 of the Limitation Act 1980, which requires contractual claims to be commenced within six years of the accrual of the cause of action.

Time bar for declaratory relief
The Purchaser argued that the declaration of non-liability was time-barred in very much the same way as any claim by the Purchaser in respect of off-spec cargo would be time-barred. However, the Commercial Court decided that, if correct, this argument would lead to the absurd position that the Seller is effectively precluded from contending in the contractually agreed forum that the Purchaser's claims are time-barred in circumstances where the Purchaser has wrongfully brought a time-barred claim in a non-contractual forum. Accordingly the Commercial Court held that this argument could not be correct.

Comment

The decision of the Commercial Court emphasises that the English courts will seek to uphold the parties' bargain concerning the resolution of differences over quality and specification. It is common for contracts to require such issues to be resolved swiftly through a process of expert determination. Further, in the absence of a speedy challenge, the independent certificate on quality should be conclusive evidence as to the cargo's quality. By introducing appropriately drafted conclusive evidence clauses into contracts, parties can ensure that determinations on quality are made swiftly and in a manner that allows the commercial consequences that may impact third parties to be actively managed. The attempts by the Purchaser in this case to belatedly raise issues outside the specified time period for resolution and their seeking to circumvent the conclusive evidence clause was given short shrift.

Perhaps less usually, it was found that the arbitration clause did not operate with respect to the dispute. The Commercial Court decided that the dispute resolution clause was a hybrid clause and the arbitration element addressed other issues. This doubtless turned on the specific wording of the arbitration clause where the time-bar mechanism, specifically in the arbitration clause, might have had the unsatisfactory outcome of leaving the parties without a forum for disputes if a stay for arbitration were granted pursuant to Section 9 of the Arbitration Act 1996. In this respect, the case should perhaps be seen in a class of its own, turning on its own specific facts.

Judge: Lionel Persey QC

Oil and Gas Financing Agreements

A range of financing agreements remain important to the operation of the oil and gas industry transactions. In light of the challenges the industry has faced over the past twelve months by a relatively low oil price, a number of important decisions relating to oil and gas financing agreements have passed through the English courts.

— In *First Abu Dhabi Bank PJSC (formerly National Bank of Abu Dhabi PJSC) v BP Oil International Limited* [2018] EWCA Civ 14, the Court of Appeal decided that a representation and warranty in a non-recourse receivables financing agreement, restricting prohibitions on disposal of receivables, was not breached when it turned out that the contract that was the source of the revenue stream contained a limitation on assignment.

— In *Vitol E&P Limited v New Age (African Global Energy) Limited* [2018] EWHC 1580 (Comm), the Commercial Court was asked to consider the relationship between a corporate lending facility and a reserve based lending facility. As such financing arrangements are common in the oil and gas industry, the approach of the Commercial Court will be of interest to many. The approach of the Commercial Court reinforces the importance of clarity in the interrelationship of financing facilities.

— In *Dana Gas PJSC v Dana Gas Sukuk Ltd and Ors* [2017] EWHC 2928 (Comm), the Commercial Court considered the validity and enforceability of an agreement governed by English law which formed part of a complex financial transaction governed by United Arab Emirates ('**UAE**') law and the principles of Islamic Sharia. In a decision that may have wide-reaching consequences for the oil and gas industry, the Commercial Court held the English law agreement to be valid and enforceable, despite the underlying UAE documentation being deemed unenforceable under UAE law.

Non-recourse receivables financing revisited by Court of Appeal – representations and warranties on assignment

In *First Abu Dhabi Bank PJSC (formerly National Bank of Abu Dhabi PJSC) v BP Oil International Limited* [2018] EWCA Civ 14, the Court of Appeal overturned the Commercial Court's decision that a representation and warranty in a non-recourse receivables financing agreement, restricting prohibitions on disposal of receivables, was breached when it turned out that the contract that was the source of the revenue stream contained a limitation on assignment.

This decision is of significant relevance to the structuring of non-recourse receivables financing in the oil and gas industry and the allocation of risk in such transactions between the seller and buyer of the debt.

Facts

On 9 December 2013, BP Oil International Ltd ('**BP**') and Société Anonyme Marocaine de L'Industrie de Raffinage ('**SAMIR**') entered into the SAMIR Agreement for the Sale and Purchase of Crude Oil which was expressly subject to English law (the '**SAMIR Agreement**'). Under the SAMIR Agreement, BP and SAMIR agreed to enter into a series of sales and purchases of crude oil in accordance with the terms and conditions set out in the SAMIR Agreement. For each transaction, payment was due some two months after delivery. By Clause 14, BP's General Terms and Conditions for Sales and Purchases of Crude Oil (2007 edition) ('**BP's General Terms and Conditions**') were incorporated. Section 34 of BP's General Terms and Conditions ('**Section 34**') provided:

> *"Section 34 – Limitation on Assignment*
>
> *Neither of the parties to the Agreement shall without the previous consent in writing of the other party (which shall not be unreasonably withheld or delayed) assign the Agreement or any rights or obligations hereunder. In the event of an assignment in accordance with the terms of this Section, the assignor shall nevertheless remain responsible for the proper performance of the Agreement. Any assignment not made in accordance with the terms of this Section shall be void."*

On 3 September 2014, National Bank of Abu Dhabi PJSC, (now known as First Abu Dhabi Bank PJSC) ('**NBAD**') and BP entered into an agreement (the '**Purchase Letter**') for the purchase by NBAD of 95% of a debt owed to BP by SAMIR in respect of an oil consignment that had been sold subject to the terms of the SAMIR Agreement.

The Purchase Letter represented a form of non-recourse receivables financing – BP received payment in respect of the debt due from SAMIR in advance of the date on which the underlying invoice was due for payment and so transferred to NBAD almost all of the credit risk of SAMIR failing to make payment.

Under the Purchase Letter, BP agreed, amongst other things, that by selling 95% of the receivable (the '**Discount Percentage**'), it had assigned to NBAD *"in equity irrevocably"* the purchased part i.e. the Discount Percent. BP also represented and warranted to NBAD at Clause 5 (b) of the Purchase Letter that:

> *"[BP] is not prohibited by any security, loan or other agreement, to which it is a party, from disposing of the Receivable evidenced by the Invoice as contemplated herein and such sale does not conflict with any agreement binding on [BP];"*

In addition, the terms of the Purchase Letter dictated that BP was to reimburse NBAD for a specified sum (c. USD 69m) if any such representation or warranty was breached.

NBAD made payment to BP in accordance with the terms and conditions of the Purchase Letter but subsequently received no payment of the debt from SAMIR. In November 2015 SAMIR filed for insolvency protection in Morocco. NBAD then contacted BP to request a *"full and legal assignment"* in respect of the debt that was compliant with Moroccan law. BP replied that it would need to obtain SAMIR's consent to the assignment pursuant to BP's General Terms and Conditions. Consequently, NBAD issued proceedings in the Commercial Court asserting breach of representation and warranty under the Purchase Letter and seeking reimbursement of the payment made to BP in respect of the debt together with interest.

The Commercial Court was asked to consider only one issue of contractual interpretation: whether or not the representation and warranty contained in the Purchase Letter, that BP was not prohibited from transferring the debt to NBAD under any other agreement, was false in light of the terms of Section 34 of the SAMIR Agreement.

Commercial Court Decision

The Commercial Court decided that Section 34 of the SAMIR Agreement meant that the representation and warranty made in the Purchase Letter (that BP was not prohibited from transferring the debt to NBAD under any other agreement) was false. NBAD succeeded at first instance in its breach of warranty claim with quantum agreed; NBAD was awarded c. USD 69m with interest.

The Commercial Court's reasoning was, in summary, that (i) the Purchase Letter provided for equitable assignment by BP of its 'chose in action' against SAMIR; (ii) because such assignment was not possible without SAMIR's consent, BP was *"prohibited"* by an *"other agreement"* *"from disposing of the Receivable"* *"as contemplated in the Purchase Letter"*; and (iii) that such sale *"conflicted"* with the SAMIR Agreement and associated contracts as *"any agreement binding on [BP]"*.

See our article regarding the Commercial Court's decision at first instance in the CMS Annual Review of Developments in English Oil and Gas Law (2017 edn.) at pg. 33-34 for more details and commentary on the first instance decision.

Court of Appeal Decision

BP appealed. The Court of Appeal was asked to decide the following issues:

Issue 1: What, on its true construction, was BP contractually prohibited from doing by the terms of Section 34?
The Court of Appeal decided that it was settled law that the Section 34 restriction, as a matter of construction, imposed a contractual obligation upon BP in favour of SAMIR not to assign BP's existing or future rights under the SAMIR Agreement in relation to performance or *"the fruits of the contract"*, even after SAMIR had performed its obligations, without prior consent. BP, as creditor, was contractually prohibited from effecting a legal or an equitable assignment of the Discount Percent of the receivables without prior consent.

However, the Section 34 wording did not impose any contractual restriction on BP from agreeing with NBAD that it would, for example (and as per paragraph 3 of the Purchase Letter):

> *"(i) within two business days, pay to [NBAD] all payments received from [SAMIR] in connection with the Invoice up to the maximum amount of the Discount Percent of the Invoice Value;*
>
> *(ii) pass onto [NBAD] within two business days of receipt of the Discount Percent of any amounts subsequently recovered by it from [SAMIR], and to receive and hold such sums as trustee on behalf of [NBAD];*
>
> *(iii) pass onto [NBAD] within two business days of receipt of the Discount Percent of any interest on any late payment recovered by it from [SAMIR], and to receive and hold such sums as trustee on behalf of [NBAD]…"*

The Court of Appeal found that as a matter of construction, the prohibition on assignment in Section 34 could not be construed as:

> *"(i) preventing the disposal to NBAD of any amounts actually received by [BP] from SAMIR, since they would not be "rights under" the SAMIR Agreement;*
>
> *(ii) preventing the creation of any trust over the proceeds of the Receivable, or indeed over the Receivable itself…;*
>
> *(iii) preventing the creation of any rights of subrogation or sub-participation..."*

Issue 2: What, as a matter of law, was the effect of such a restriction on BP's ability to dispose of the receivables?
It was common ground between the parties, for the purposes of the Court of Appeal hearing, that without SAMIR's consent any purported equitable assignment was ineffective to amount to an equitable assignment of BP's contractual rights under the contract to the debt represented by the Discount Percent of the receivable (although not the proceeds once received by BP).

Issue 3: In the circumstances and as a matter of construction of the Purchase Letter, as at the relevant date (i.e. the date of the Purchase Letter and Discount Date) was BP in breach of the representation and warranty contained in Clause 5 (b) of the Purchase Letter?
There was no dispute in respect of the relevant principles the Commercial Court should consider when analysing the construction of Section 34. The Commercial Court referred to those principles as affirmed most recently in the Supreme Court's judgment in *Wood v Capita Insurance Services Ltd* [2017] UKSC 24, applying *Arnold v Britton* [2015] UKSC 36 and emphasised that:

> *"…construction is essentially a unitary exercise which should be neither uncompromisingly literal nor unswervingly contextualised. As has been frequently repeated, the task of construction is to see what reasonable parties in the position of the parties, with their background knowledge, would have understood the relevant wording to have meant."*

Disagreeing with the Commercial Court at first instance, the Court of Appeal decided that the proper construction of the Purchase Letter in its context meant that BP was not in breach of the representation and warranty contained in Clause 5 (b) of the Purchase Letter.

The Court of Appeal's reasoning for reaching this conclusion was as follows:

- At the date of the Purchase Letter, a payment guarantee entered into by BP and NBAD was in force (the '**Guarantee**'). The Guarantee related to the SAMIR Agreement and provided for the possibility that there might be a contractual restriction against, or restriction on the assignment of rights under the agreement. The Purchase Letter expressly cancelled and replaced the Guarantee. The Court of Appeal found that this was a factor in favour of BP's construction of Section 34.
- The primary means contemplated by the Purchase Letter of transferring the economic benefit was the immediate payment (within two business days) by BP to NBAD of the Discount Percent of sums received by BP from SAMIR, with a trust imposed on the receipts while in the hands of BP. The assignment only took effect to the extent that sums had not been received or paid over. The Court of Appeal found that the Purchase Letter clearly envisaged other methods of disposing of the economic value of the Discount Percent of the receivables.
- There was no reason why the obligation, under Clause 3 (iv) of the Purchase Letter *"to assign…if legally possible under the applicable law and the Contract, to [NBAD] its rights title, interest and claims against the Buyer in respect of the Discount Percent of the Receivable and the rights and benefits of the relevant transaction arising from the Contract to the extent of any payment made by [NBAD] and not paid…"* should be confined to legal assignment. The Court of Appeal disagreed with the Commercial Court's construction of that provision and found that the phrases *"if legally possible under applicable laws and the Contract"* and *"where, if not legally possible or effective for any reason"* had to be construed as contemplating that neither legal nor equitable assignment might be possible.
- The provision that BP had assigned the Discount Percent of the receivable *"in equity irrevocably"* to NBAD was expressly subject to contractual carve outs, which contemplated that an assignment might not be able to take place, as such alternative remedies and rights were afforded to NBAD. The Court of Appeal found that the Commercial Court had failed to give those carve outs any weight in reaching its decision.

The Court of Appeal then turned to consider the construction of Clause 5 (b) of the Purchase Letter.

The Court of Appeal found force in BP's argument that the words *"or other agreement"* did not include the SAMIR Agreement, on the ground that the SAMIR Agreement was a defined term which should have been mentioned if it was meant to have been a relevant agreement.

In addition, the Purchase Letter contemplated that equitable assignment might not be possible and provided for other means of transferring the economic benefit. There was no basis for construing the words *"disposing"* or *"sale"*, in Clause 5 (b) of the Purchase Letter, as referring exclusively to equitable assignment. As such, Section 34 did not prohibit the disposal of the receivable or its Discount Percent in the manner contemplated in the Purchase Letter. Therefore, the Court of Appeal ultimately decided that there had been no breach of the warranty provided by BP in Clause 5 (b).

Comment

The Court of Appeal's reversal of the Commercial Court's decision in respect of NBAD's breach of warranty claim will be welcomed by parties who regularly seek non-recourse receivables financing. The Court of Appeal's decision meant that BP's arrangement with NBAD was not unwound and therefore, in the event of an actual insolvency occurring, BP would not find itself exposed to the insolvency risk which it had specifically contracted with NBAD to avoid.

On the other hand, purchasers seeking to contract on similar non-recourse receivables financing arrangements may now insist on more stringent and tightly drafted warranties from sellers. In addition, warranty provisions drafted using similar language to that of Clause 5 (b) of the Purchase Letter may be less likely to be agreed by purchasers, for fear that the warranty would not afford them the protection they require.

Parties providing warranties in such arrangements should ensure that such warranties are clear and indeed capable of being provided in the context of the underlying contracts to avoid any arguments such as those asserted by NBAD in this case.

Finally, this case leaves an unresolved question of law that might be of significant importance to such transactions. Whilst it was common ground between the parties that, without SAMIR's consent, any purported equitable assignment was ineffective to amount to an equitable assignment of BP's contractual rights (see Issue 2 above), this was because the House of Lords decision in *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd* [1994] 1 AC 85 ('**Linden Gardens**') was adopted by the parties as having such effect.

However, in delivering its judgment, the Court of Appeal made reference to Professor Sir Roy Goode's article, Contractual Prohibitions against Assignment [2009] LMCLQ 300. In this article, Professor Goode sets out his view that such bars to assignment are relevant only to the legal relationship between the debtor and creditor. If that is correct then such bars to assignment would not prevent equitable assignment or assignment of the fruits of the contract by the creditor. Further, a contractual provision that sought to prevent a transfer of equitable rights or fruits of performance would be void as offending public policy concerning rights of alienation.

With Professor Goode's position in mind, Lady Justice Gloster expressed *"intellectual disappointment"* that the assignment principles derived from the decision in Linden Gardens did not stand to be decided upon by the Court of Appeal.

Judges: Gloster LJ, Patten LJ, Briggs LJ

"Hanged on a Comma"? Punctuation in Oil and Gas Financing Agreements

Summary

In *Vitol E&P Limited v New Age (African Global Energy) Limited* [2018] EWHC 1580 (Comm), the Commercial Court was asked to consider the relationship between a corporate lending facility and a reserve based lending facility. As such financing arrangements are common in the oil and gas industry, the approach of the Commercial Court will be of interest to many in the industry. The approach of the Commercial Court reinforces the importance of clarity in the interrelationship of financing facilities.

Facts

New Age (African Global Energy) Limited ('**New Age**') indirectly owned a 25% share in the licence in respect of the offshore area of hydrocarbon reserves named 'Block Marine XII' offshore West Africa. In order to enable New Age (through its subsidiaries) to meet capital commitments in respect of its participation in Block Marine XII, Vitol E&P Limited ('**Vitol**') and New Age entered into a facility agreement for a loan to New Age (the '**Facility**'). At the time of the Facility, it was envisaged that New Age would also enter into a reserve based lending facility (the '**RBL Facility**') with other lenders (the '**RBL Lenders**'). Vitol agreed to negotiate with the RBL Lenders the terms of an intercreditor agreement within a specified negotiation period. Vitol and New Age executed a financing fee side letter in connection with the Facility (the '**Side Letter**').

Pursuant to Clause 3.1 of the Side Letter, New Age agreed to pay a financing fee of USD 2.00 per BBL in respect of each of the first 22.5m barrels of crude oil lifted from the Block Marine XII asset. There was also provision for the fee to be reduced to USD 1.00 per BBL as follows:

> *"provided that, if the intercreditor agreement is not exercised by the relevant parties by the end of the intercreditor negotiation period, the borrower may elect to prepay the facility in full out of the proceeds of the RBL facility and, following the date of prepayment in full and provided that the final discharge date has occurred, within 10 business days following the expiry of the intercreditor negotiation period the financing fee shall be reduced to \$1.00 per BBL."*

Vitol invoiced New Age for the full financing fee, assessed at USD 2.00 per BBL. New Age disputed the invoice and paid the lower amount of USD 1.00 per BBL. Vitol brought proceedings to recover the difference between the price invoiced and the price paid. The dispute turned on whether the phrase *"within 10 business days following the expiry of the intercreditor negotiation period the financing fee shall be reduced"* meant:

— (the New Age argument) once the Facility had been repaid, the reduction of the fee occurred at a point in time falling *"within 10 business days following the expiry of the intercreditor negotiation period"*; or

— (the Vitol argument) the fee was to be reduced only if prepayment of the Facility (and the final discharge date) had occurred within 10 business days following the expiry of the negotiation period.

Decision

The Commercial Court found in favour of Vitol. In giving judgment, the Commercial Court recalled the textual and contextual approach to interpretation in *Wood v Capita Insurance Services Ltd* [2017] UKSC 24.

Analysis of the text

— Clause 3.1 of the Side Letter had to be construed as a whole, including the words, syntax and punctuation, in order to determine the objective meaning. There was no requirement that interpretation should be supported by any immutable principle of grammar or syntax.

— On New Age's interpretation, it immediately struck an objective reader as odd that a fee was to be

reduced *"within"* a period of 10 business days; the normal meaning of the word *"within"* did not connote a fixed date.

— However, there was no apparent mechanism to determine the date on which the fee reduction was to occur. That appeared to lead to an *"unworkable result"* and suggested that it was not the natural meaning of the clause.

— By contrast, Vitol's interpretation led to the conclusion that the comma was incorrectly placed. There was a very great difference between inserting or removing words and concluding that punctuation had gone awry. Moreover, if, as New Age contended, the phrase *"shall be reduced"* was intended to reflect a reduction in the fee which would operate with effect from a date in the past, clear language might have been expected to make that distinction explicit by use of a phrase such as *"with effect from such date"*.

— Therefore, the natural meaning of the language in Clause 3.1 was not unambiguous.

Analysis of the purpose and commercial effect

— It was common ground that the purpose of the fee reduction was to provide an incentive for Vitol to agree to the subordination of the Facility to an intercreditor agreement within the negotiation period. If the negotiation failed, repayment could still be made at the reduced financing fee.

— The ten-day period was the mechanism for effecting drawdown and repayment once the outcome of the negotiations was known. Since the fee was part of the overall return that Vitol received in return for lending funds to New Age, it would produce a surprising result if the fee reduction occurred with effect from the end of the ten day window following the expiry of the intercreditor negotiation period, even where the loan was not repaid and Vitol continued to have a commercial exposure by reason of its loan to New Age under the Facility.

— In those circumstances, Vitol would be receiving a substantially lower fee even though the Facility had not been repaid.

Conclusion on interpretation
The position of the comma was not and could not be conclusive. The Commercial Court had to strike a balance between the indications given by the language and the implications of the competing constructions, while remaining alive to the possibility that one side might have agreed to something which, with hindsight, did not serve its interests. When the rival interpretations were tested against the commercial consequences, including the commercial purpose of Clause 3.1, Vitol's interpretation, viewed objectively, was the natural, objective meaning of the language of that provision and, when checked against the commercial consequences, it was consistent with business common sense.

Comment

It is not entirely apparent whether Vitol and New Age were ever on the 'same page' as to the operation of the reduction in the fee. Deals drafted under time pressure, for good reason, can result in circumstances where the parties have a different understanding as to the commercial bargain reached. If this occurs, the prospects for an eventual dispute increase. It seems that Vitol's interpretation was favoured by the Commercial Court as the alternative was thought to be uncommercial. As such, it is a reminder that, if an outcome is sought that might be considered uncommercial, clear drafting is likely to be required.

Unlike the conclusion in this case, commas can be important. In 1916, a Roger Casement was executed for treason under the Treason Act 1351. He had committed the offence in Germany. The Treason Act read: *"if a Man … be adherent to the King's Enemies in his Realm giving to them Aid and Comfort in the Realm or elsewhere… that ought to be judged Treason"*. During the trial, the question was whether the offence only applied to adherence to enemies *"in [the] Realm"*. The judges reviewed the original Norman French text and, in effect, inserted a comma into the unpunctuated text, crucially altering the sense so that *"in the Realm or elsewhere"* referred to where the adhering to enemies was done and not just to where the *"King's enemies"* might be. Roger Casement was said to have been *"hanged on a comma"*.

The consequences of moving a comma in the current case were much less severe for New Age. The distinction drawn between *"inserting words which are not there or removing words which are there"* and *"concluding that the punctuation has gone wrong"* suggests that the English courts will be more flexible when interpreting a provision with incorrect punctuation, as opposed to incorrect words.

Judge: Moulder DBE J

Importance of place of performance

In *Dana Gas PJSC v Dana Gas Sukuk Ltd and Ors* [2017] EWHC 2928 (Comm), the Commercial Court considered the validity and enforceability of an agreement governed by English law which formed part of a complex financial transaction governed by UAE law and the principles of Islamic Sharia. In a decision that may have wide-reaching consequences for the oil and gas industry, the Commercial Court held the English law agreement to be valid and enforceable, despite the underlying UAE documentation being deemed unenforceable under UAE law.

Facts

The claimant, Dana Gas PJSC ('**Dana Gas**'), is a UAE public joint stock company and is the Middle East's first and largest regional private sector natural gas company. In 2007, Dana Gas raised USD 1bn through the issue of certificates which were tradable and listed on the Irish Stock Exchange. Dana Gas was unable to raise finance by directly issuing securities or taking out a straightforward loan without breaching the Sharia prohibition on payments of 'riba' (interest) being paid on loans or investments. As such, the certificates, being types of an Islamic bond known as a 'sukuk', were intended to be compliant with Sharia law.

The type of sukuk used in the transaction was a 'sukuk al-mudarabah'. This type of bond is derived from the Mudarabah partnership structure, and essentially is a joint venture in which one party invests capital and the other invests skill and labour with a view to making, and splitting, a profit. Dana Gas entered into the joint venture with Dana Gas Sukuk Ltd (the '**Trustee**').

In 2013, the transaction was restructured when new certificates were issued with an aggregate face value of USD 850.08m. At the time of the restructure, Dana Gas obtained legal opinions that the transaction was compliant under Sharia, UAE and English law.

The Trustee issued the certificates and both the proceeds of the issue and the assets were held by the Trustee on trust for the certificate holders. The Trustee then contributed capital (i.e. the amounts received from the certificate holders) to be invested by Dana Gas (in its gas company operations). The profits generated were to be split each quarter in a ratio of 99% to the Trustee and 1% to Dana Gas. These profits were expected to fund quarterly payments to the certificate holders, with any excess to be kept in a reserve account, along with the principal amount of the certificates on redemption. These arrangements were set out in an agreement, governed by UAE law, between Dana Gas and the Trustee (the '**Mudarabah Agreement**').

In an attempt to protect the certificate holders from the risk of insufficient funds for quarterly payments or repayment of the principal amount, Dana Gas entered into the Purchase Undertaking (the '**Undertaking**'). The Undertaking granted to the Trustee rights to oblige Dana Gas to buy *"all of the Trustee's rights and benefits and entitlements in and to the Mudarabah Assets"* (by executing a Sale Agreement) at the relevant exercise price (the '**Exercise Price**'). These rights could be exercised following the occurrence of certain events, as prescribed in the Undertaking. The Undertaking was governed by English law, although the Sale Agreement was drafted to be governed by the laws of the UAE.

Arguments of the Parties

Dana Gas' main complaint was that the Undertaking had the effect of guaranteeing the certificate holders the return from their investment by removing the risk of a loss of capital, which is said to be inconsistent with Sharia law and the prohibition of 'riba'. On this basis, Dana Gas claimed that the Undertaking, and as such, the transaction as a whole, was unlawful, therefore rendering all of the relevant contractual obligations unenforceable as a matter of UAE law.

Dana Gas relied on the following to establish its case:

— On a proper construction, the obligation to pay the Exercise Price under the Undertaking is conditional upon the parties being able to effectively transfer the Trustee's rights to the Mudarabah Assets by entering into a valid Sale Agreement – which they could not do; or alternatively,

— The Undertaking was void for common mistake on the basis that both parties entered into it on the understanding that:

  - the Mudarabah Agreement would be lawful and enforceable under UAE law;
  - the Sale Agreement would be valid under UAE law; and
  - the Trustees had rights or benefits that could be the subject of the Sale Agreement; or alternatively,

— That as a matter of public policy, the English courts will not enforce the obligations under the Undertaking (including the obligation on Dana Gas to pay the Exercise Price).

Interim Applications

In June 2017, Dana Gas issued proceedings in the English Commercial Court and in July 2017, were granted an order for an expedited trial with a hearing to be held before or shortly after 31 October 2017, as agreed by all of the parties. In the same instance, the Commercial Court granted an injunction over the Undertaking in favour of Dana Gas. In addition, Dana Gas also sought and was granted an injunction in the UAE prohibiting the Defendants from taking any action under the Mudarabah Agreement and the Undertaking or any related agreement until the matter had been decided in the UAE. In the following months, various interim applications were heard and some granted in both England and the UAE, including an order to apply to discharge injunctions granted in England, an anti-suit injunction granted in the UAE and a decision as to the questions the Commercial Court would consider when deciding whether the Undertaking was enforceable or not. The Commercial Court eventually gave its decision on the enforceability of the Undertaking on 17 November 2017 after the Sharjah Court decided to adjourn the UAE proceedings until 25 December 2017.

Decision

The Commercial Court decided in relation to the claim under UAE law that the judgment would only deal with the position at English law. The central issue therefore became whether the Undertaking was valid and enforceable as a matter of English law. *Prima facie*, the Undertaking was enforceable as it was explicitly governed by English law and interest is perfectly lawful under English Law. The fact that the Undertaking would be invalid in another country was irrelevant.[1]

The Commercial Court reached the following decisions:

Construction of the contract
Dana Gas' argument regarding the construction of the Undertaking was rejected on the basis it was *"untenable and flatly inconsistent"* with the *"express wording"* of the Undertaking. On a proper construction, the obligation of Dana Gas to pay the Exercise Price arose once a valid exercise notice had been served. The transfer of the rights explicitly came following the payment of the Exercise Price; paying the Exercise Price was merely the first stage. It was clear that the clause was constructed so that potential invalidity did not affect Dana Gas' obligation to pay the Exercise Price.

Mistake
When considering Dana Gas' claim for mistake, the Commercial Court followed Lord Aitken's formulation of the doctrine of mistake in *Bell v Lever Bros* [1932] AC 161. The question of whether a contract is void for mistake is one of construction: *"if the contract impliedly or expressly makes a particular assumption a condition of its validity, there is no valid contract if the assumption is false"*. In addition, the Commercial Court found that in order to rely on the doctrine of mistake, the 'mistake' must be common between the parties to the contract and must render performance of the contract impossible, or change the subject matter completely. In circumstances where the contract expressly or impliedly allocates risk, the exercise of establishing mistake becomes harder. As such:

[1] See *Kleinwort, Sons & Co v Ungarische Baumwlle Industrie AG* [1939] 2 KB 678

- The Undertaking specifically accounted for the scenario in which the Mudarabah Agreement was rendered unenforceable and illegal, being a *"Dissolution Event"*. In circumstances where a Dissolution Event has arisen, the Trustee is entitled to enforce the Undertaking. It follows that there can be no operative mistake, as the contract explicitly provides for the situation that has (or allegedly has) arisen.
- In considering whether the parties had mistakenly thought that they could transfer the assets by way of the Sale Agreement, the Commercial Court held that this argument was also *"untenable"* as the mistake had been contractually allocated. On a proper interpretation, and as mentioned above, the Undertaking had been structured to ensure that any difficulty in transferring the rights to the Mudarabah Assets did not affect Dana Gas' obligation to pay the Exercise Price.
- Dana Gas also alleged that the Trustee's rights could not be subject to the Sale Agreement as once the Mudarabah Agreement was void, the Trustee would acquire no rights. Again, the Commercial Court found that this risk had been accounted for and allocated to Dana Gas.

Therefore, all of Dana Gas' obligation claims for mistake fell at the first hurdle.

Public policy
The final argument relied on by Dana Gas was one of public policy. In particular it relied on:

— the 'Ralli Brothers' principle which provides that *"English law will not require a party to do something which is unlawful by the law of the country in which the act has to be done"* (see *Ralli Brothers v Cia Naviera Sota y Aznar* [1920] 1 KB 614); and

— Article 9(3) of the Rome I Regulation, which provides that *"effect may be given to the overriding mandatory provisions of the law of the country where the obligations arising out of the contract have to be or have been performed, in so far as those overriding mandatory provisions render the performance of the contract unlawful"*.

Both rules of law are only applicable if the obligations in question have to be performed in the UAE. Dana Gas' obligation under the Undertaking was to pay the Exercise Price into the *"Transaction Account"*, being an account maintained by the Trustee with Deutsche Bank in London. The Undertaking did not require Dana Gas to carry out the obligation in the UAE, and as such could not be deemed unlawful as a matter of public policy.

As to Dana Gas' alternative argument that *"the English courts will not enforce a contract that is unlawful under the law of a friendly foreign state"*, the Commercial Court held it an essential element that the acts take place in the country in which they are illegal. On the facts, there was nothing to indicate that the Undertaking had the intention of requiring Dana Gas to do anything illegal in the UAE. Further, nothing in the Undertaking suggested the Sale Agreement was to be executed in the UAE.

The Commercial Court therefore held that the ground upon which Dana Gas relied in order to challenge the validity and enforceability of the Trustee's rights under the Undertaking was unfounded, and the Undertaking was valid and enforceable in accordance with its terms.

Comment

The case serves as a salient reminder on two important drafting points:

— where the parties have allocated risks in a contract, English law will not usually intervene to override that allocation by rendering it unenforceable or invalid; and

— where a payment obligation arises, the place of performance is usually determined by the relevant bank account where payment is to be made. As such, English law will generally consider payment to be lawful (and therefore the contractual obligation to make payment valid) provided it is a valid obligation in the place of the relevant bank account.

If a risk is provisioned for (in this case it was the risk of the Mudarabah Agreement not being enforceable), it will not be deemed a mistake that is capable of voiding the contract. Where drafting has specifically dealt with the allocation of risk between the parties, English law will not generally permit principles of English law (such as mistake) to intervene in that contractual allocation.

Accordingly, parties drafting purchase undertakings should think carefully about the potential risks (including invalidity, illegality and repudiation) and where these should be assigned, as once assigned it is unlikely that the law will intervene to reallocate those risks.

The case is also of note when dealing with choice of law and validity of obligations to make payments. It is common for oil and gas agreements dealing with underlying assets around the world, including finance, to require payments to be made in bank accounts in major western financial centres (e.g. London). In many cases, this will mean that it is difficult to challenge the obligation to make payment on the basis that doing so would not be legal in the jurisdiction where the underlying asset resides. The relevant test is whether the payment is legal in the place where the payment is to be made.

In the context of Islamic finance, the case may also set a precedent for companies arguing that they do not have to honour debts that are not Sharia compliant. If the transaction is to take place in England and the payment agreement is governed by English law, then any potential illegality in a foreign jurisdiction will not be relevant as there will be nothing requiring that party to commit an illegal act in that country.

Judge: Leggatt J

Supply Chain and EPC Contracts

Oil companies continue to make significant supply chain expenditures, which puts engineering, projects and construction (‘**EPC**’) spending at the heart of managing risk. The English courts have dealt with a range of issues this year relevant to managing supply chain and EPC risks, some directly related to the oil and gas industry others relevant through the issues being dealt with in the case.

- In *Petroleum Company of Trinidad and Tobago Ltd v Samsung Engineering Trinidad Co Ltd* [2017] EWHC 3055 (TCC), the Technology and Construction Court considered a dispute regarding the splitting of an oil industry project into offshore and onshore contracts for tax purposes. Such structures rarely come before the courts and this case provides useful insights into the complex drafting issues that can arise when seeking to implement such structures.
- In *HSM Offshore BV v Aker Offshore Partner Limited* [2017] EWHC 2979 (TCC), the Technology and Construction Court considered the interaction of a modifying ‘Memorandum of Understanding’ on the original contract. It emerged that neither party had achieved quite what they say they intended.
- In *Interserve Construction Ltd v Hitachi Zosen Inova AG* [2017] (TCC), the Technology and Construction Court decided that a contractor should have been given the opportunity to remedy its breach before its contract was terminated.
- In *MT Højgaard A/S v E.ON Climate and Renewables UK* [2017] UKSC 59, the Supreme Court decided that a contractor was liable to comply with a ‘fitness for purpose’ type obligation contained in a technical schedule despite the arguably lesser obligations elsewhere in the contract to exercise ‘reasonable skill and care’ and to comply with an ‘international standard’.
- In *Rock Advertising Limited v MWB Business Exchange Centres Limited* [2018] UKSC 24, the Supreme Court overturned the long-held legal position that allowed a contractual clause requiring variations to the contract to be in writing to be overridden by a later oral agreement. Although not an oil and gas industry case, this critical decision is likely to affect most oil and gas agreements.

Contract splitting in international construction and energy projects

In *Petroleum Company of Trinidad and Tobago Ltd v Samsung Engineering Trinidad Co Ltd* [2017] EWHC 3055 (TCC), the Technology and Construction Court (the '**TCC**') considered a dispute regarding the splitting of an oil industry project into offshore and onshore contracts for tax purposes. Such structures rarely come before the courts and this case provides useful insights into the complex drafting issues which can arise when seeking to implement such structures.

Facts

The Petroleum Co of Trinidad and Tobago Limited ('**Petrotrin**') entered into construction contracts with Samsung Engineering Trinidad Co Ltd ('**Samsung**') for the construction of a new CCR Platformer Complex and Substation at one of its refineries in Trinidad. The contractual arrangements were split into two contracts, an onshore contract with a local Samsung subsidiary ('**Samsung Trinidad**') and an offshore contract with Samsung's principal Korean contracting entity ('**Samsung Korea**').

The splitting of the works in this way was purely to provide a tax advantage to Samsung. In addition to the offshore and onshore contracts, both Samsung Trinidad and Samsung Korea entered into an umbrella agreement with Petrotrin which was intended to ensure that the splitting arrangements did not cause any disadvantage to Petrotrin (referred to by the parties as a '**Linkage Agreement**').

Samsung Trinidad commenced arbitration proceedings against Petrotrin under the onshore contract. Petrotrin counterclaimed for delay liquidated damages. An issue arose as to the applicable cap for delay liquidated damages. The onshore agreement limited these to 10% of the contract price stated in the onshore agreement. The offshore agreement had similar wording. However, the Linkage Agreement provided that, *"the maximum liquidated damages under each Contract [i.e. the offshore and onshore contracts] and this Agreement shall be an amount equal to ten percent (10%) of the Total Agreement Amount"*. The Total Agreement Amount was defined as the aggregate of the contract prices payable under the offshore and onshore contracts.

The Arbitral Award

The arbitral tribunal rejected Petrotrin's case that the aggregate cap from the Linkage Agreement should apply to its counterclaim. The arbitral tribunal noted that the arbitration had been commenced under the onshore contract and the issue before it was therefore the proper interpretation of the cap in the onshore contract. The arbitral tribunal disagreed that the Linkage Agreement was to be taken as conflicting with and/or amending the cap in the onshore contract. In the arbitral tribunal's view, the aggregate cap in the Linkage Agreement was to be read as a *"long-stop limit which sits above the lower cap applicable under a single agreement"*. The arbitral tribunal acknowledged Petrotrin's argument that this interpretation meant that the cap under the Linkage Agreement could never apply (i.e. it added nothing to the two caps under the onshore and offshore agreement), but considered that there was nothing unusual in such provisions being added as a precaution.

TCC – Challenge to title the Arbitral Award

Petrotrin subsequently challenged the arbitral tribunal's award before the TCC under section 67 of the Arbitration Act 1996 dealing with jurisdictional challenges. The challenge was rejected on the basis that the issue was one of contractual interpretation rather than jurisdiction and that, in any event, the arbitral tribunal's conclusions as to jurisdiction were correct.

Comment

Contract splitting is frequently used to generate tax efficiencies in international construction and energy projects. This usually involves splitting the project into offshore and onshore elements. The offshore elements will usually comprise design and manufacturing works to be performed outside the local jurisdiction in which the project is to be delivered. The onshore elements comprise the balance of the work, including delivery of the project inside the local jurisdiction. Separate contracts are entered into for the offshore and onshore elements, usually with separate onshore and offshore contracting entities (although the procuring entity will usually stay the same).

Through these means, exposure to local taxation laws in relation to the offshore elements is sought to be reduced. In particular, the lack of a taxable nexus in the local jurisdiction may mean that the income or profits arising from fees paid under the offshore contract are not subject to corporate or income taxes in that jurisdiction. Supplies made under the offshore contract may also not fall within the scope of value added tax, sales taxes or other indirect taxes in the local jurisdiction, potentially creating a saving for the procuring entity (to whom these may otherwise represent a final cost).

A 'bridge' or 'umbrella' agreement is also usually agreed to deal with interface issues and to ensure that the procuring entity is not prejudiced by the splitting arrangements. This agreement may be between the procuring entity and both the offshore and onshore contracting entities, or between the procuring entity and a guarantor entity. The precise structure of the split contracts and any umbrella agreement will depend on the tax treatment likely to be obtained within the local jurisdiction in which the project will be delivered.

This case demonstrates the importance of careful drafting when seeking to implement a split contractual structure. The commercial intention - behind the Linkage Agreement at least - appears to have been to allow Petrotrin to recover delay liquidated damages up to 10% of the total of the contract sums payable under both the offshore and onshore contracts from either of the Samsung entities. That would have been the position had both elements of the works been contained in a single contract, and had that intention been achieved it would have meant that Petrotrin had not been put at a disadvantage by the splitting of the contracts, which was the very purpose of the Linkage Agreement. However, a combination of limited arbitration provisions and inconsistent drafting around the liquidated damages cap led to a finding that separate and distinct caps applied to each of the Samsung entities.

Had broader arbitration provisions been included in the three contracts, it may have been open to Petrotrin to make its counterclaim directly under the Linkage Agreement rather than seeking to rely on that agreement indirectly to influence the interpretation of the offshore agreement.

Splitting contracts introduces a considerable amount of additional legal complexity in comparison to a single contract structure. Aside from liability caps and arbitration provisions, the list of other issues to consider includes scope gaps, cross-contract claims and defences (e.g. onshore contractor relying on delays by the offshore contractor), testing and completion under the separate contracts, termination, defects liability and joint notification provisions. While the tax benefits are potentially large, and may enable a procuring entity to have a project delivered at a reduced price, the parties should ensure that proper advice and attention is given to these contractual issues to ensure that no unintended consequences arise as a result of the split structure.

Judge: Coulson J

Memorandum of (mis) understanding: pitfalls of a subsequent agreement on an underlying contract

Where problems arise in oil and gas contracts, it is not uncommon for the parties to seek to address those problems arising under the original contract with a subsequent, modifying, agreement. In *HSM Offshore BV v Aker Offshore Partner Limited* [2017] EWHC 2979 (TCC), the Technology and Construction Court considered the interaction of one such modifying 'Memorandum of Understanding' ('**MOU**') with the original contract. In the dispute that subsequently arose regarding final payment for the contract works, it emerged that neither party had achieved quite what they bargained for.

The decision serves as a reminder to parties to consider not only the short-term issues they may wish to address in order to get a project back on track, but also the ramifications of any new agreement for the contract as a whole.

Facts

Aker Offshore Partner Limited ('**Aker**') engaged HSM Offshore BV ('**HSM**') to carry out the fabrication of two process modules, for use on the Clyde Platform in the Flyndre-Cawdor oilfield in the North Sea.

The contract between Aker and HSM (the '**Contract**') incorporated LOGIC sub-contract conditions, and contained a list of key milestone dates to be met by HSM, including *"module ready for Sail Away"* (the '**RfSA date**'). The RfSA date was to be 10 May 2015. However, the project encountered problems and it became apparent that the RfSA date would not be met. To get the project back on track, HSM and Aker agreed the MOU, which was dated, and intended to have effect from, 18 March 2015. The MOU provided that *"[i]n return for HSM utilising their fullest endeavours to complete Mechanical Completion for Process Modules M12 and M14 on or before July 1st 2015 HSM will receive the following concessions against the CONTRACT".* The various concessions included a change to the way in which HSM was remunerated. Under the MOU, HSM was also required to produce a revised programme for the project, which listed 19 July 2015 as the revised RfSA date.

Sail Away eventually occurred on 10 August 2015. Soon thereafter, a series of disputes relating to almost every aspect of the Contract arose, although only certain of these were eventually heard by the TCC. In particular, HSM sought to recover sums it claimed were outstanding under the MOU, and argued that Aker had no entitlement to review invoices previously approved by them. Meanwhile, Aker disputed those claims and launched a counterclaim for liquidated damages due to the delayed RfSA.

Decision

The RfSA date and Liquidated Damages

The first issue before the TCC was the effect of the MOU on the RfSA date and the liquidated damages provisions within the Contract.

Under Clause 35 of the Contract, HSM was to be liable to Aker for liquidated damages if it *"fails to complete any of the items listed in [a separate Appendix] in accordance with the relevant date included in the SCHEDULE OF KEY DATES"*. The Appendix set liquidated damages for *"delay to the Module completion and ready for Sailaway date"* at EUR 150,000 per day, up to a maximum liability of EUR 1.5m.

Aker claimed liquidated damages under the Contract. It contended that if the MOU had any effect on the RfSA date, it was to extend it to 19 July 2015, which date HSM had not met. HSM, meanwhile, argued that the MOU had the effect of removing a binding RfSA date altogether.

The TCC concluded, in light of the factual matrix and the circumstances leading to the MOU, that the original RfSA date of 10 May 2015 was no longer in effect. After all, *"[b]oth parties knew that the 10 May 2015 date would not be achieved. Indeed, that was why the MOU had come into being in the first place".* It would not therefore make sense for the MOU to retain a contractually binding RfSA date of 10 May 2015.

The TCC also decided that there was no express RfSA date in the MOU, and the date contended for by Aker (19 July 2015) did not have any contractual effect, being merely a *"hoped-for date to which everyone was working".*

Further, the TCC decided that the MOU removed a binding RfSA date from the contractual framework, and with it any entitlement to liquidated damages. The Contract contained an absolute obligation to achieve Sail Away by a certain date, whereas the MOU replaced that with an obligation to use *"fullest endeavours"* to achieve a different stage ('**Mechanical Completion**') which was not absolute. The MOU did not make any mention of sanctions for failing to do so, nor (as pointed out, oddly, by Aker) did it *"even refer to RfSA or liquidated damages"*. The MOU obligation to use *"fullest endeavours"* was contradictory to the Contract obligation to achieve RfSA by a fixed date, and so obviously superseded it.

In those circumstances, provided HSM utilised their *"fullest endeavours"*, they would not be in breach of Contract, let alone liable for liquidated damages, regardless of when Mechanical Completion or RfSA actually occurred.

Estoppel and payment of invoices

The second issue before the TCC was whether monthly invoices rendered by HSM, and approved, certified, and paid by Aker, could be subject to later review or otherwise disputed. HSM argued that Aker were estopped from disputing that the invoice sums were properly due.

The TCC rejected this argument – giving no less than five 'short' reasons for doing so, along with one 'long' reason that considered the full factual evidence of the invoice approval process. The clearest of those reasons was found in the terms of the Contract itself. Clause 17.9 of the Contract expressly stated that *"the COMPANY may correct or modify any sum previously paid"* where a sum was incorrect or not properly payable, and that *"[n]either the presentation nor payment or non-payment of an individual invoice"* constituted a waiver of any right.

Interestingly, the decision gives some insight as to why such an unsuccessful estoppel argument arose at all. In the course of the trial, witnesses for HSM suggested that the MOU had the result of making the contract a fully reimbursable one. However, this understanding was incorrect: although the MOU did make changes to specific elements of HSM's remuneration to a 'cost plus' basis, those individual changes were identified in the MOU. The MOU did not otherwise change remuneration under the Contract. As a result of this, it was apparent that large parts of HSM's invoices – amounting to some EUR 20m – now disputed by Aker, might not be properly payable under the express terms of the MOU. The estoppel argument therefore only arose *"because HSM belatedly realised that the MOU did not say what [they] wanted it to say"*.

Comment

The arguments made (and lost) by both parties demonstrate the importance of ensuring that parties do not lose sight of the impact of an agreement made part way through performance of a project, often with a view to expediting or incentivising completion, on the underlying contractual position.

It is not unusual for 'issues' to arise during a project and for the parties to alter their agreement in order to get the project back on track. However, as this case arguably shows, if the parties are not clear as to how the terms of the subsequent agreement link back to the original contract, there is the risk that parties may unintentionally alter contractual entitlements and/or obligations – as both HSM and Aker found out. Therefore, care must be taken by contracting parties to ensure that the full picture is understood by those involved in negotiating and drafting the terms of the modifying agreement in order to ensure that the ramifications of the amendment are fully considered and understood.

Rather than an *ad hoc* MOU, as was agreed in this case, in many cases it will be preferable for parties to capture any changes in an amendment agreement, drafted in a way which clearly sets out those terms of the original contract that are to be affected. Of course, this can involve more detailed drafting at the time than parties valuing speed might prefer – but should assist in avoiding costly misunderstandings.

Judge: Coulson J

Tread lightly terminating – contractors may be due one more chance

In *Interserve Construction Ltd v Hitachi Zosen Inova AG* [2017] (TCC), the TCC highlighted that a contractor should have been given the opportunity to remedy its breach before its contract is terminated due to the existence of a notice provision. Although this is not an oil and gas industry case, similar contractual provisions exist in many oil and gas supply chain and EPC contracts.

Facts

The defendant, Hitachi Zosen Inova ('**HZI**'), was a contractor who entered into a design and build sub-contract with the claimant, Interserve Construction Limited ('**ICL**').

Clauses 43.1 and 43.1A of the sub-contract stated:

> *"43.1 If [any relevant termination events occur] then, subject to sub-clause, 43.1A (…) the purchaser may forthwith by notice terminate the employment….*
>
> *43.1A …may (at its absolute discretion) notify the Contractor of the default and if the Contractor fails to commence and diligently pursue the rectification of the default within a period of seven (7) Days… terminate the employment of the Contractor under the Contract."*

On 7 July 2015, HZI issued a termination notice to ICL which listed a number of events that justified the immediate termination of their contract, stating that it was relying on the termination Clauses 43.1 and 43.1A. HZI also stated in the notice that it would not exercise its discretion to provide ICL with an opportunity to rectify the alleged defaults under Clause 43.1A.

ICL sought a Civil Procedure Rules Part 8 declaration that these two Clauses together should be read in a way that ensures HZI must first give notice to terminate under 43.1A, and thereafter wait until the seven-day rectification period has expired before actually terminating.

Decision

The TCC found for ICL and followed *Wood v Capita* [2017] UKSC 24 which held that the textual approach of the objective meaning of the words was appropriate as the contract was a complex commercial document which had been carefully negotiated by two sophisticated commercial parties. Accordingly, the words *"subject to"* clearly indicated that the right to terminate was limited to a situation where Clause 43.1A had first been effected.

The TCC also found that Clause 43.1A's reference to *"absolute discretion"* did not make the seven-day period optional. Rather, the proper construction of the words meant that if HZI had failed to give notice to terminate, it would not be taken to mean that no default existed or any breach was waived.

Comment

The TCC's interpretation relied heavily on the way in which similar terms were used elsewhere in the contract between the two parties. As such, this case is a good reminder that when drafting, lawyers should keep in mind that the courts will not review contractual terms in isolation and that a contract that contains inconsistent provisions may produce unexpected outcomes.

That said, the decision is also consistent with a number of previous legal authorities where the existence of a notice provision in the termination clause was considered critical to its interpretation and operation.

Parties should note that where a terminating event does occur, if the terminating party's *"absolute discretion"* to terminate has been limited by a term in the contract, then that party is bound by that limitation (as was the case here). A contracting party's particular right cannot be at its *"absolute discretion"* as well as *"subject to"* a different term in the contract without one of those phrases giving way.

More generally, parties should adopt a cautious approach when terminating a contract, ensuring that the relevant notices are issued and the termination procedure specified in the contract is carefully followed.

Judge: Jefford J

Supreme Court rules on fitness for purpose dispute

In *MT Højgaard A/S v E.ON Climate and Renewables UK Robin Rigg East Limited* [2017] UKSC 59, the Supreme Court confirmed that a contractor would be liable to comply with a fitness for purpose type obligation contained in a technical schedule despite obligations elsewhere in the contract to exercise reasonable skill and care and to comply with an international standard. Although this is not an oil industry decision, it will have significant ramifications for the interpretation of EPC contracts, which commonly incorporate technical schedules and other specification documents within their terms.

Facts

MT Højgaard ('**MTH**') was engaged by E.ON Climate and Renewables UK Robin Rigg East Limited ('**E.ON**') to design, fabricate and install the foundation structures for 60 offshore wind turbines in the Solway Firth. Shortly after completion, grouted connections incorporated within the foundation structures failed. The parties agreed that E.ON would develop a scheme of remedial works, the cost of which amounted to EUR 26 million. Litigation proceeded in order to determine who should bear that cost.

In April 2014, the TCC held that MTH was liable to E.ON for breach of contract because the design of the foundations was not fit for purpose. The TCC's reasoning was based on two paragraphs in the Technical Requirements section of an Employer's Requirements schedule to the contract (the '**Technical Requirements**') which required that the design of the foundations *"shall ensure a lifetime of 20 years in every aspect without planned replacement"* (the '**TR Paragraphs**'). This provision applied in addition to MTH's other less onerous obligations such as a requirement to exercise reasonable skill and care and to comply with an international standard for the design of offshore wind turbines known as J101.

Compliance with J101 was also intended to bring about a service life of 20 years, subject to a probable rate of failure of between 1 in every 10,000 to 100,000 installations. As a matter of professional design practice, the adoption of J101 was consistent with a desire to achieve a design life of 20 years and MTH reasonably relied on the standard in preparing its design. However, J101 contained a significant error, not known about at the time the contract was entered into, which dramatically reduced the service life of the foundations. Compliance with J101 did not therefore provide a design life of 20 years in reality.

The Court of Appeal overturned the TCC's decision, finding that the TR Paragraphs were inconsistent with the rest of the contract and the obligation to comply with J101 in particular. Those paragraphs were *"too slender a thread"* upon which to hang a finding that MTH gave a warranty of 20 years for the life of the foundations. The Court of Appeal emphasised the fact that an ordinary person in the position of the parties would have known that J101 was the normal design standard required of offshore wind farms. More was required, therefore, than two paragraphs described as being *"tucked away"* in the Technical Requirements if a much more onerous obligation was to be imposed warranting a 20-year lifetime come what may.

Supreme Court Decision

In a unanimous decision, the Supreme Court overturned the Court of Appeal's decision and restored the decision of the TCC:

— Whilst the TCC and the Court of Appeal had interpreted the TR Paragraphs as a warranty that each of the foundation structures would have a minimum lifetime of 20 years, the Supreme Court was minded to give those paragraphs a slightly narrower interpretation requiring only that they be designed to last for 20 years. This narrower interpretation would allow scope for probabilistic failures of the kind envisaged by J101 (i.e. 1 in 10,000 to 100,000). It was ultimately unnecessary for the Supreme Court to rule on this issue as either interpretation would have placed MTH in breach of contract: both are in the nature of fitness for purpose obligations which require the achievement of a result rather than the exercise of reasonable skill and care.

— The Supreme Court disagreed that the TR Paragraphs were inconsistent with the balance of the contract. The Supreme Court referred to a number of previous decisions in the UK and in Canada where contractors had accepted obligations to achieve certain performance criteria whilst at the same time agreeing to implement a certain design or specification. No inherent inconsistency arises where the performance criteria proves impossible to achieve if the agreed design or specification is to be adhered to. Whilst each case depends on its own facts, *"the message from decisions and observations of judges in the United Kingdom and Canada is that the courts are generally inclined to give full effect to the requirement that the item as produced complies* *with the prescribed criteria, on the basis that, even if the customer or employer has specified or approved the design, it is the contractor who can be expected to take the risk if he agreed to work to a design which would render the item incapable of meeting the criteria to which he has agreed".*

— The Supreme Court noted that the requirement to comply with J101 was expressed as being a minimum requirement and that MTH was obliged to identify any areas where a more rigorous design was needed. This would also have been the position even without express wording in this particular case. It could not have been envisaged that MTH would have been in breach of contract if it had sought to improve on the requirements of J101. There was therefore no actual inconsistency between the TR Paragraphs and the rest of the contract.

— The Supreme Court also disagreed that the TR Paragraphs were insufficiently prominent or *"too slender a thread"* to support the more onerous fitness for purpose obligation alleged by E.ON. The Supreme Court was particularly unimpressed by an argument that paragraphs such as these contained in a technical schedule should not be readily interpreted as imposing additional onerous obligations above those spelled out in the primary contract conditions. Given that the technical schedule in question had been given contractual force by the parties, it was to be taken at face value.

Comment

This decision will have significant ramifications for the interpretation of construction contracts, which routinely incorporate schedules and technical documentation often with less than complete harmonisation as to intended legal standards of design and workmanship. The Supreme Court agreed with the Court of Appeal's characterisation of the contract in this case as being comprised of documents of *"multiple authorship"*, which contained *"much loose wording"*. Despite this, it found no reason not to give effect to the natural meaning of the two TR Paragraphs, imposing a more onerous fitness for purpose type obligation in addition to MTH's other obligations to exercise reasonable skill and care and to follow the J101 standard.

The decision may be seen as a further example of a return in emphasis to the natural and ordinary meaning of contract provisions observed by many commentators since the Supreme Court's earlier decision in *Arnold v Britton*. Although no overall change in the approach to interpretation has occurred, arguments which depend upon a reading down of particular parts of a contract because of their commercial implications or because they are less prominent than might be expected will face an uphill battle.

In light of this decision, parties should consider making clear in their general contract conditions whether and how technical schedules are to affect overall obligations as to design and workmanship. Contractors may wish, for example, to include paramountcy provisions which state that nothing in any of the schedules to the contract is to impose a design obligation of a greater standard than reasonable skill and care. Employers wishing to impose fitness for purpose type obligations in combination with obligations to adhere to certain standards or designs should make clear that those standards or designs represent minimum obligations as found by the Supreme Court in this case.

In the absence of wording intended to restrict fitness for purpose obligations being found in schedules, it should be remembered that English law will usually seek to interpret contracts so as to give effect to all elements. In most cases contracts can be interpreted to avoid inconsistency, so a paramountcy clause that purely states that one element of the contract has precedence over another might be of little practical impact.

Judges: Lord Neuberger PSC, Lord Mance JSC, Lord Clarke JSC, Lord Sumption JSC, Lord Hodge JSC

'No oral variation clause': Supreme Court changes law

In *Rock Advertising Limited v MWB Business Exchange Centres Limited* [2018] UKSC 24, the Supreme Court overturned the long-held legal position that allowed a contractual clause requiring variations to the contract to be in writing to be overridden by a later oral agreement. This is a critical decision that is likely to affect most oil and gas agreements.

Facts

Rock Advertising Ltd ('**Rock**') entered into a licence with MWB Business Exchange Centres Ltd ('**MWB**') to occupy office space for a fixed term of 12 months. The licence contained a clause requiring all variations to be set out in writing and signed on behalf of both parties.

Six months later, the director of Rock had a telephone conversation with MWB's credit controller about payment arrears. The High Court found that, during this conversation, a variation to the payment schedule was agreed. However, MWB treated the variation as merely a proposal and ultimately rejected the varied schedule, locked Rock out of the premises for failure to pay the arrears, and terminated the licence.

Supreme Court Decision

The Court of Appeal had previously held that, as a matter of principle, a *"no oral modification"* ('**NOM**') clause cannot be effective because party autonomy dictates that parties are free to vary the clause itself orally. Where parties agree orally to vary a contract containing a NOM clause, the Court of Appeal held that it was necessarily implied that they also intended to vary the NOM clause to allow the oral variation. See page 60 onwards of the 2016 edition of the CMS Annual Review of developments in English oil and gas law.

The Supreme Court disagreed. Lord Sumption, giving the leading judgment, found that the proper understanding of party autonomy is that parties are free to bind their future conduct by agreement. This includes the manner in which future changes to their legal relations are to be achieved, as in a NOM clause. Lord Sumption made particular note of the certainty this will give contracting parties and corresponding reduction in litigation risk. The effect of this is that a NOM clause will successfully prevent oral modification of the contract, unless the NOM clause itself is first varied in accordance with its own requirements, i.e. in writing.

Lord Briggs concurred with the outcome on slightly different grounds. He held that NOM clauses can be varied orally, but only by an express reference to the NOM clause or where the variation is a strictly necessary implication of the parties' subsequent agreement. This would usually only be the case where the agreement was immediately implemented in circumstances giving rise to an estoppel. On the facts, this did not apply in the current case.

Comment

Article 31.3 of the OGUK JOA provides that an amendment must be by *"written instrument"* and *"executed"*. As such, it seems likely that amendments to JOAs based on the OGUK model form will require a further executed contract or side letter.

The AIPN Model Form JOA (2012) requires an amendment to be a *"written amendment"* and *"signed"*. Clause 11 of the LOGIC Drilling Contract requires variations to be *"evidenced in writing"*. Clause 74.5 of the BP Oil International Limited General Terms & Conditions for Sales and Purchases of Crude Oil and Oil Products (2015) also require modifications to be *"evidenced in writing"*. As such it seems that an oral variation will not be permitted. However, there remains an interesting issue of whether an exchange of emails may be sufficient to amount to an amendment for the purposes of such clauses.

In *C&S Associates UK Ltd v Enterprise Insurance Company plc* [2015] EWHC 3757 (Comm), the Commercial Court decided that:

— An exchange of emails was *"in writing"* for the purposes of a NOM clause.

— The Court of Appeal's decision in *Golden Ocean Group Ltd v Salgaocar Mining Industries Pvt Ltd* [2012] EWCA Civ 265, could be applied by analogy. The Court of Appeal decided that agreement by a series of negotiating emails containing electronic signature blocks satisfied the requirements of section 4 of the Statute of Frauds 1677 that requires a contract of guarantee to be in writing and signed by each party. As such, an email with a signature block was *"signed"*.

On the face of *C&S Associates UK Ltd v Enterprise Insurance Company plc*, it has apparent relevance to the ability of parties to amend/vary contracts by email and in the context of NOM clauses found in the many industry model form contracts used in the industry, such as AIPN Model Form JOA (2012), LOGIC Drilling Contract and the BP Oil International Limited General Terms & Conditions for Sales and Purchases of Crude Oil and Oil Products (2015).

It remains to be seen whether *C&S Associates UK Ltd v Enterprise Insurance Company plc* remains good law. However, if it is the intention of drafters to avoid amendment or variation by email it would seem a sensible step to specifically exclude emails from being a valid amendment or variation. In many cases, this will require words additional to those used in existing model forms. See page 64 of the 2016 Annual Review for further information.

As a result of the Supreme Court decision, it will be significantly more important to pay attention to the exact terms of NOM clauses. If it is the parties' intention to amend or vary a contract and there is a NOM clause, the safest option will be to enter into a written amendment complying with the terms of the NOM clause.

Judges: Lady Hale, Lord Wilson, Lord Sumption, Lord Lloyd-Jones, Lord Briggs

M&A and Corporate Structure

The increasing complexity of M&A transactions and corporate structures across the hydrocarbons sector has resulted in cases ranging from the meaning of 'payable' in a tax indemnity to the liability of parent companies in tort for the actions of their subsidiaries. Some of these decisions will have a material impact on oil companies moving forward.

— In *Minera Las Bambas SA & Anor v Glencore Queensland Ltd & Ors* [2018] EWHC 1658 (Comm), the Commercial Court was asked to decide the scope of a tax indemnity concerning VAT 'payable'.

— In *Apache Beryl Ltd v Marathon Oil UK Limited and ors* [2017] EWHC 2258 (Comm), the Commercial Court was asked to decide whether consent to a sale was properly withheld.

— In *Ogale Community & Ors v Royal Dutch Shell Plc and Shell Petroleum Development Company of Nigeria Ltd* [2018] EWCA Civ 191, the Court of Appeal was asked to determine a parent company's liability in tort. The comments of the Court of Appeal regarding a 'duty of care' will doubtless result in oil companies considering their corporate group decision making and emergency response structures.

— In *Zayo Group International Ltd v Ainger and others* [2017] EWHC 2542 (Comm), the Commercial Court considered whether there was valid service of a contractual warranty notice. Although it is not an oil and gas case, the decision of the Commercial Court will be relevant to oil and gas warranty claims.

— In *Koza Ltd & Anor v Akcil & Others* [2017] EWHC 2889 (Ch), the High Court provided much-needed guidance on the interpretation of the phrase *"in the ordinary and proper course of business"*. Although not an oil and gas M&A case, the reasoning given by the High Court will likely be of relevance to M&A sale and purchase agreements using the words *"in the ordinary and proper course of business"*.

Tax indemnities in international M&A: when does tax become payable?

In *Minera Las Bambas SA & Anor v Glencore Queensland Ltd & Ors* [2018] EWHC 1658 (Comm), the Commercial Court decided that VAT was not 'payable' for the purposes of a tax indemnity in a share purchase agreement and related deed of indemnity until it became coercively enforceable. Here, this meant the Peruvian tax court had to determine that the VAT was due before it became payable for the purposes of the agreement. The Commercial Court also decided that neither the reduction of a credit balance nor the reduction of refunds otherwise payable in respect of VAT constituted *"tax payable"* for the purposes of the indemnification provisions. The case provides an interesting analysis of the tax indemnity provisions often used in international M&A transaction documents, both in the natural resources sector and elsewhere.

Facts

Minera Las Bambas S.A.C. and MMG Swiss Finance AG (the '**Purchasers**') had entered into a share purchase agreement ('**SPA**') with Glencore Queensland Limited and Glencore South America Limited (the '**Sellers**') for the purchase of Xstrata Peru S.A., which was the indirect owner of a mining project in Peru. The sale and purchase of the shares completed in July 2014.

The target group had in November 2011 entered into a swap agreement in connection with the project, under which a transfer of land took place between Minera Las Bambas S.A.C. and a rural community. No Peruvian VAT was accounted for in relation to the swap agreement, but following closing under the SPA in July 2014 the Peruvian tax authorities issued a tax assessment asserting that VAT was payable by the target group in connection with the swap agreement.

The SPA included a tax indemnity under which the Sellers agreed to pay the Purchasers an amount equal to any *"tax payable"* by a group company that related to the period prior to closing and had not been discharged or paid on or prior to closing. The SPA also granted conduct rights for the Sellers in relation to any third party claims that could result in the Sellers becoming liable to the Purchasers under the SPA, subject to the Sellers indemnifying the Purchasers against any related costs and expenses. Having entered into a deed of indemnity for this purpose, the Sellers exercised their rights to take conduct of the VAT claim, and disputed it with the Peruvian tax authority.

In the case before the Commercial Court, the Purchasers were seeking to recover the outstanding amount of VAT from the Sellers on the basis that the assessment by the tax authority had resulted in it being payable, notwithstanding the ongoing dispute. Alternatively, they asserted that the reduction by the Peruvian tax authority of the credit balance for the target group (against which the VAT payable by the target group to the tax authority could be set off), or the reduction of amounts of VAT otherwise refundable to the target group, fell within the scope of tax payable by the target group.

Decision

In determining the meaning of *"payable"*, the Commercial Court followed the rules of contractual construction set out by Lord Hodge in *Wood v Capita Insurance Services Ltd* [2017] UKSC 24, and considered in turn the language of the relevant clauses, the documentary context, the factual matrix and the commercial consequences of the rival interpretations.

Due to the sophistication of the parties involved and the respective agreements being drafted with the assistance of international law firms, the Commercial Court attached significantly less weight to the factual matrix. Less weight was also attached to the commercial background of the case and previous authorities regarding the meaning of the term *"payable"*.

Having evaluated the term in the wider context of the SPA and the deed of indemnity, the Commercial Court concluded that the meaning of *"payable"* in the circumstances was limited to the narrower concept of *"due"*. An amount would therefore not be payable until it could be coercively enforced, with the result that the Peruvian VAT would not be payable for the purposes of the SPA or deed of indemnity until the outcome of the dispute with the tax authority before the Peruvian tax court.

The Commercial Court also found that:

- The indemnity given in the deed of indemnity entered into upon the Sellers exercising their rights to take conduct of the claim was not limited to amounts accrued before closing of the SPA, and was in fact a full indemnity for any amount payable under the claim.
- Upon taking conduct of the claim, the Sellers were entitled to utilise their rights to the detriment of the Purchaser's ability to recover under the SPA.
- The reduction by the Peruvian tax authorities of the Purchasers accumulated VAT credit balance was not equivalent to an actual payment and would only amount to tax *"payable"* if it would result in the output tax exceeding the input tax, such that there would be a resulting debt owed to the Tax Authority for the relevant period.

Comment

International share acquisitions in the natural resources sectors will often include a short-form tax indemnity or tax covenant in the body of the relevant share purchase agreement, which seeks to protect the purchaser against bearing the cost of unexpected pre-closing tax liabilities arising in the target group. Unlike the more comprehensive tax deeds usually seen on UK deals, these short-form indemnities may not be accompanied by specific drafting regarding the timing of payment in relation to tax liabilities.

The case produced a logical commercial result that would be expected from such an indemnity, in that payment does not have to be made by the Sellers until the underlying liability to pay the tax authority has been determined (at least in circumstances where the underlying liability is disputed). However, the judgment also notes that, on the basis of the determined meaning of *"payable"*, a claim under the SPA could fall outside the limitation period if the underlying liability had not been determined by a court until after the limitation period had expired. This was not a key issue – since the subsequent deed of indemnity covered the liability – but it would probably not be the expected position between the parties for an issue identified during the limitation period, particularly given the time periods over which tax assessments can be raised and disputed.

From a wider perspective, the case also suggests that where sophisticated parties have been advised by international law firms the courts are likely to give more weight to the wording of the contract than to wider commercial considerations. As a result, purchasers should be careful to ensure that any potential ways in which a liability could manifest itself are covered through the drafting: for example, to ensure that the offsetting of a tax liability against a refund is treated in the same manner as a liability to make a payment to a tax authority.

Judge: Moulder J

Consent in M&A Deals

In *Apache Beryl Ltd v Marathon Oil UK Limited and ors* [2017] EWHC 2258 (Comm), a dispute arose from the acquisition by a private equity entity of the interest in a wholly owned subsidiary of Apache Beryl Ltd ('**Apache**'). Marathon Oil UK Limited and the other joint venture parties (together the '**Brae Group**') initially withheld consent to the disposal by Apache. The Commercial Court was asked to decide whether that consent was properly withheld.

Facts

Apache and the Brae Group were party to the Scottish Gas Evacuation System Heads of Agreement entered into on 14 June 1990 and restated on 28 February 2005 (the '**SAGE HOA**'). The venture was for the ownership, operation and use of infrastructure to transport hydrocarbons. The infrastructure included the Beryl pipeline, the Brae pipeline, the main pipeline and the processing terminal (the '**SAGE HOA Assets**'). Apache held a 37.27% interest in the SAGE HOA Assets.

Apache emailed the Brae Group expressing its intention first to transfer its interests in the SAGE HOA to a wholly owned subsidiary, Sage North Sea Limited ('**SNSL**'), and, secondly, to sell the shares in SNSL to Ancala Midstream Acquisitions Limited ('**Ancala**') pursuant to a put and call option. The email enclosed an execution deed which the Brae Group was invited to sign to enable the deal to proceed.

Clause 15 of the SAGE HOA permitted a participant to assign all or part of its interest provided that it procured that *"the assignee will be legally bound by the same liabilities and obligations and entitled to the same rights in respect of the interest transferred as was the assignor"*. For this purpose, the clause provided that appropriate novation agreements shall be executed by the participants. However, it also stated in paragraph (c) that:

> *"No assignment of an interest in the Main Pipeline and Processing Terminal shall become effective until the Participants have received such reasonable assurances as they may require to ensure that the assignor's obligations under this Heads of Agreement, including but not limited to abandonment, will be performed."*

Apache contended that it had provided all of the assurances to which the Brae Group was entitled. The Brae Group disagreed.

If Apache's position was correct, it was entitled to go ahead with the transfer of its interest under the proposed sale to SNSL followed by the sale to Ancala, and the Brae Group was obliged to execute the necessary novation agreements. If not, Apache was not entitled to go ahead and any purported assignment would be ineffective.

There was a longstop date in the put and call option of 21 October 2017. On that basis, the Commercial Court ordered an expedited trial.

Settlement

The matter between Apache and the Brae Group settled before trial. However, it highlighted the potential complications in obtaining the consent of participants to the sale of assets. Therefore, the question remains of what approach the Commercial Court would adopt.

However, the issue of consent was considered from a banking perspective by the Commercial Court in the recent case of *Crowther and Crowther v Arbuthnot Latham & Co Limited* [2018] EWHC 504. The Commercial Court considered whether agreements specifying that consent is not to be unreasonably withheld confer a true discretion on the parties that is wide-ranging and can be exercised reasonably, or if the consent clause will admit only one right answer in certain circumstances. The approach of the Commercial Court might be instructive on future cases concerning oil and gas assets.

Facts

The Claimants had entered into a loan agreement with Arbuthnot Latham & Co Limited, the Defendant bank, for the extension of a loan of around EUR 6m (the '**Loan Agreement**') which was secured on property (the '**Property**'). As the lender, the Defendant's consent was required for the Property to be sold. Under the Loan Agreement, such consent was *"not to be unreasonably withheld or delayed"*. The Claimants received an offer for the Property which was in line with market valuations and sought permission from the Defendant to sell the Property. The Defendant considered the offer to be *"agreeable"*. However, it decided that consent would only be provided if the Claimants gave security for the balance of the loan that would remain unsecured following the sale of the Property.

The Claimants argued that the Defendant was being unreasonable in withholding its consent and that the question of reasonableness should be decided by reference to the value of the offer made on the Property. The Defendant considered that it was being reasonable in withholding its consent if no further security was provided because it needed to protect its commercial position.

The Claimants sought a declaration that if the price offered for the Property aligned with market valuations then it was unreasonable for the Defendant to withhold its consent.

Decision

The Commercial Court decided that a reasonable man test applied. The Commercial Court found that the main purpose of the consent clause under the Loan Agreement was to ensure that the Property be sold at market value. By reference to the landlord and tenant case of *Straudley Investments Limited v Mount Eden Land Limited* (1997) 74 P&CR 306, the Commercial Court found that the Defendant had unreasonably withheld consent to the sale of the Property because the Defendant's reasoning for refusing consent was unrelated to ensuring the Property was sold at a fair price. As a consequence, it was incompatible with the purpose of the provision.

The Commercial Court did not consider that the Wednesbury reasonableness test established by the Court of Appeal in *Barclays Bank Plc v Unicredit AG* [2014] EWCA Civ 302 (the '**Wednesbury Test**') was applicable as the Commercial Court found that the Wednesbury test is one of rationality as opposed to a common law reasonable man test. In *Barclays Bank Plc v Unicredit AG*, the relevant contractual provision had permitted Barclays to act in a *"commercially reasonable manner"* – which was different to the clause in this case.

Commentary

Crowther and Crowther v Arbuthnot Latham & Co Limited highlights the potential importance of formulating the wording of contractual consent provisions to the test that English law may apply. In refusing to apply the Wednesbury Test the Commercial Court might be said to have effectively removed a significant discretion that the Defendant might otherwise have had in exercising its rights in its own commercial interests. Instead, by focusing on a narrower reasonable person test, it might be said that it was able to substitute its own requirements of the reasonable answer in the circumstances of the specific facts.

However, the landlord and tenant cases concerning 'unreasonably withheld' provisions arguably result in similar outcomes and reasoning to consent cases relating to the Wednesbury Test. Although the Commercial Court supposedly applies an objective test of reasonableness, in reality, it recognises that the landlord is usually entitled to act in its own financial interests. As a consequence, the outcome of such cases is often materially the same as if the Wednesbury Test had applied.

In this respect, the authorities on contractual discretion, where the Wednesbury Test applies, were considered by the Supreme Court in *Braganza v BP Shipping Limited* [2015] UKSC 17 and the Commercial Court in *Ludgate Insurance Company Limited v Citibank NA* [1996] L.R.L.R. 247. The general approach appears to be:

- The circumstances in which a court will interfere with the exercise by a party to a contract of a contractual discretion given to it by another party are extremely limited.
- A discretion must be exercised honestly and in good faith for the purposes for which it was conferred.
- It must also be a true exercise of discretion in the sense that it was not capricious, arbitrary or perverse.

Whilst it might seem difficult to challenge the operation of such discretion, it is important to note that the discretion must be exercised for the purpose for which it was conferred. The purpose of a discretion is unlikely to entitle a party to seek to better its commercial position, as opposed to protecting its existing position. In effect, this was what the Commercial Court in *Crowther and Crowther v Arbuthnot Latham & Co Limited*, applying a different reasonableness test, decided that the Defendant was seeking to do – secure security beyond its existing entitlement.

As such, in exercising a consent discretion, it seems likely that oil companies will be entitled to have regard to their own commercial interests. Specifically, they will generally not be asked to sacrifice existing rights and interests. However, caution should be displayed in any conduct that might be said to seek to better an existing financial or commercial position by seeking to withhold consent. Such conduct might be said to not be in accordance with the purpose of the consent provision, and therefore unreasonable, regardless of whether a Wednesbury Test or 'objective' reasonable person test is applied to the requirement/obligation to consent.

Judge: Waksman QC

Are you in control? Parent company liability in Ogale Community v Shell

In *Ogale Community & Ors v Royal Dutch Shell Plc* ('**RDS**') *and Shell Petroleum Development Company of Nigeria Ltd* ('**SPDC**') [2018] EWCA Civ 191, the Court of Appeal confirmed that a claim against an English-domiciled parent of a foreign oil and gas company may not proceed in the English courts if the claimants are unable to prove that the parent owed them a duty of care. The comments of the Court of Appeal regarding a 'duty of care' will doubtless result in oil companies considering their corporate group decision making and emergency response structures.

In reaching its majority decision (Sales LJ dissenting), the Court of Appeal departed from the reasoning of the TCC at first instance. That decision had placed more emphasis on the nature of and relationship between the legal entities. Although it ultimately dismissed the claim as the TCC had done, the Court of Appeal gave far greater scrutiny to the Shell group's policies and procedures.

The decision highlights that while, generally, *"corporate structure itself tends to militate against the requisite proximity"* required for a duty of care, the courts will nevertheless look closely at the influence of group policies, and the extent of practical or shared control the parent has over the operations that are the subject of a claim.

Facts

In summary, members of the Ogale community (the '**Claimants**') in Nigeria commenced proceedings in the TCC for damages against parent company RDS and operating subsidiary SPDC, alleging serious ongoing pollution and environmental damage caused by oil spills from SPDC's pipelines.

The claim against Nigerian-domiciled SPDC could only proceed in England, however, if jurisdiction could be established with English-domiciled RDS qualifying as an 'anchor defendant'. The Claimants therefore had to prove that there was 'a real issue' between the Claimants and RDS *"which it is reasonable for the court to try"*. To do so, they had to prove an arguable duty of care owed by RDS to the Claimants.

At first instance, the TCC held that there was no such duty of care owed by RDS. The Claimants had not satisfied the tripartite Caparo test of reasonably foreseeable damage, proximity, and reasonableness (failing on the second and third limbs).

The key issue was the second Caparo limb, proximity. The TCC applied the decision in *Chandler v Cape Plc* [2012] EWCA Civ 525 that merely holding shares in a subsidiary will not, by itself, give rise to a duty of care. Whilst there may be circumstances where a duty of care could arise, they did not apply in this case. Firstly, RDS did not conduct operations itself, in Nigeria or anywhere else; nor, in Nigeria, was it permitted to do so. It was not a party to the relevant joint venture agreement. Secondly, decisions taken by the Executive Committee (the '**ExCo**') of the Shell group were not decisions taken by RDS; the Shell group and RDS were not the same legal entity and the executive officers of RDS who sat on the ExCo were in a minority. In dismissing the relevance of public statements relied on by the claimants, the TCC found that the statements had been made in relation to the Shell group generally, and did not weigh heavily when considering whether a duty of care existed. Policies merely starting with *"all Shell companies must"* were insufficient to prove a duty of care.

Court of Appeal Decision

Could the Court of Appeal reconsider the TCC's decision?

The Court of Appeal decided that it was appropriate to reconsider the decision at first instance. The TCC had made certain errors of principle in failing to consider factual evidence presented by the Claimants. It was also incorrect in its assessment of ExCo; there was an arguable case that the actions of ExCo were attributable to RDS.

The central question: proximity
The Court of Appeal agreed with the TCC, however, on the central question at issue. For the second *Caparo* limb of proximity to be met, it was necessary to establish that RDS had control (or joint control) over SPDC's operations.

The Claimants pointed to five factors, which they argued demonstrated such control by RDS:

- mandatory policies, standard and manuals issued by RDS;
- mandatory design and engineering practices imposed on SPDC;
- a system of supervision and oversight of the implementation of RDS's standards;
- financial control by RDS over SPDC in respect of spending; and
- a high level of centralised direction and oversight of SPDC's operations.

Did RDS exercise a substantial degree of control (or joint control) over SPDC's operations?
As a preliminary matter, all three judges agreed that the Claimants could not simply point to the existence of policies and standards issued by RDS, intended to apply throughout the Shell group company, in order to establish a duty of care. Instead, a more substantial degree of control by RDS of SPDC's operations was needed.

By a majority of two to one, the Court of Appeal decided that the Claimants had failed to prove that the five factors identified amounted (together or separately) to a sufficient degree of control to establish the necessary degree of proximity.

Simon LJ found that the various policies, practices, and public statements relied on by the Claimants merely revealed *"a centralised system based on industry standards and the Shell Group's own developed best practice"* which applied to all Shell companies. Such standardisation and sharing of best practice was to be expected in the context of a business operating internationally, and did not evidence a substantial degree of control over SPDC specifically. Whilst other evidence suggested that there were specific concerns about SPDC's operations in Nigeria, these were high-level business concerns. At its highest, RDS ensured that controls were in place, to be implemented by SPDC; it did not exercise control over SPDC's operations.

Sir Geoffrey Vos was of the view that the documents relied upon by the Claimants were of the sort to be expected, from a commercial perspective, in an international business. They were general ones, not *"tailored"* specifically for SPDC. Such group standards were not enough to prove an *"imposition"* of mandatory practices, especially where there was no evidence that RDS *"took upon itself the enforcement of the standards"*. Similarly, RDS wanting to be kept abreast of *"significant issues"* with operations by SPDC in Nigeria, a particularly risky region, was not the same as RDS assuming responsibility for, or controlling, the day-to-day operations of SPDC.

Dissent

Sales LJ disagreed with the majority. He found that there was a good arguable case that RDS owed the Claimants a duty of care. Notably, he was also more willing than the majority to give weight to the evidence of so-called *"whistleblower"* witnesses for the Claimants. Based on this witness evidence, and on certain central policies – in particular, the *"Shell Control Framework"* – Sales LJ concluded that RDS had the means to assert executive power and control aspects of the management of operating group companies, like SPDC, if it wished to do so. In the case of SPDC, it was plausible that RDS had exercised this power.

Comment

On the one hand, the outcome of this case is positive for large international oil and gas companies. The decision confirms that a parent company will not normally be liable for the actions of an operating subsidiary by virtue of ownership or group corporate policies. As noted by Sir Geoffrey Vos in the majority, *"it would be surprising if a parent company were to go to the trouble of establishing a network of overseas subsidiaries with their own management structures if it intended itself to assume responsibility for the operations of each of those subsidiaries"*.

However, the Court of Appeal's approach – in considering whether, in fact, the parent had taken control of the operations of the subsidiary – showed a far greater willingness than the TCC to look beyond corporate structure alone, and investigate how a company group is managed in practice. As a consequence, companies should consider carefully the extent to which they are able, in fact, to direct the actions (or do, in fact, direct actions) of their operating subsidiaries where this might give rise to claims in tort from third parties.

Oil and gas groups might also be well advised to consider whether any emergency response planning might have the unintended impact of spreading potential tortious liability to other group members and invoke the jurisdiction of the English courts.

Judges: Sir Geoffrey Vos, Simon LJ, Sales LJ

Effective service of warranty claims: following notice provisions to the letter

In *Zayo Group International Ltd v Ainger and others* [2017] EWHC 2542 (Comm), the Commercial Court took a strict interpretation of a contractual notice provision concerning the service of warranty notices. Although it is not an oil and gas case, the decision of the Commercial Court will be of relevance to oil and gas warranty claims.

Facts

The case concerns a share purchase agreement ('**SPA**') by which Zayo Group International Ltd ('**Zayo**') purchased a company from seven management vendors and a private equity fund (the '**Vendors**'). After the sale, Zayo brought several warranty claims and served them by courier on the very last day on which the notice could be served in accordance with the SPA. Upon arriving at the address with the notice of claim for service of Ms Jaggard (one of the Vendors), the courier was informed that Ms Jaggard had moved and no longer lived at the address. The courier did not leave the notice of claim at the address for service, instead he chose to deliver it to one of the other Vendors who had already received the notice. Ms Jaggard did become aware of the warranty claims, although not through service of the notice of claim to the address set out in the SPA.

The key questions for the Commercial Court were whether there was effective service on Ms Jaggard, and whether the management sellers were therefore liable for the warranty claims.

Decision

The Commercial Court looked at the express language and provisions of the notice clause, following the approach taken in *Rainy Sky SA v Kookmin Bank* [2011] UKSC 50, namely that the Commercial Court should consider which construction of the clause is more consistent with business common sense. It found that under the SPA, notice is served by delivering the notice to the address (as opposed to personal service on the individual) where the notice is left. This could also have been achieved by posting it through the letter box, pushing it under the door or leaving it with a person at the address. The Commercial Court recognised that valid service might therefore not bring the notice of claim to the relevant individual. However, in the present case, since the letter was not left at the address for service of Ms Jaggard, the notice was not validly served.

The notice clause provided for an alternative address *"as may be notified in writing from time to time"*. The Commercial Court decided that this was purely permissive – in other words, the fact that Ms Jaggard did not notify a change of address was not a breach of the notice clause. It was also irrelevant that Ms Jaggard became aware of the warranty claims through other means.

This had significant consequences for Zayo. The Commercial Court decided that under the SPA, a failure to notify all of the Vendors meant that none of them were liable for the warranty claims. The issue concerning notice was seen to be a 'knock-out' blow, rendering all other issues academic.

Comment

This decision emphasises the importance of following contractual notice provisions with utmost care. Even if the notice of claim had never been personally served on Ms Jaggard, valid notice would have been given if the notice had been left at the address for service.

Before serving notice on a counterparty, consider the following aspects of the contractual notice clause:

- Is notice served by delivering the notice to the address, or by personally serving the notice on the individual?
- If the notice clause provides for an alternative address, 'must' this be notified to the other parties, or is it a permissive option for the party changing address for service?
- Where possible, it is preferable to serve notice with time to spare before the notice period expires as this may allow time for the notice to be re-issued should problems arise with the initial service.

Judge: Simon Bryan QC

High Court provides further guidance on the meaning of 'ordinary course of business'

In *Koza Ltd & Anor v Akcil & Others* [2017] EWHC 2889 (Ch), the High Court provided much-needed guidance on the interpretation of the phrase *"in the ordinary and proper course of business"*. Although not an oil and gas M&A case, the reasoning given by the High Court will likely be relevant to M&A sale and purchase agreements using the words *"in the ordinary and proper course of business"*.

Facts

Koza Limited ('**Koza**'), a company incorporated in England and Wales, became embroiled in criminal proceedings in Turkey as part of the Koza group which was accused by Turkish authorities of financing terrorism.

In that context, a dispute arose in 2015 in respect of a general meeting called by Koza. Following on from that dispute, an English court of first instance issued an order in 2016 which, amongst other things, provided that Koza should not, until further order or full trial, *"dispose of, deal with or diminish the value of any funds belonging to [it] or held to [its] order other than in the ordinary and proper course of business"* (the '**Undertaking**').

Koza later applied to the High Court to vary the order and approve three expenditures to: (i) finance arbitration proceedings on behalf of Koza's parent company; (ii) retain a firm of public relations consultants; and (iii) pay for the services of its CEO by way of remuneration.

Decision

The High Court considered a number of factors in assessing whether the relevant expenses were *"in the ordinary and proper course of business"*, and in particular asked the following:

— Would an objective observer, with knowledge of Koza, its memorandum of association and its business, view the proposed expenditure as being made in the ordinary and proper course of its business?

— On the proper interpretation of the Undertaking, did the parties intend the proposed expenditure to fall within the ordinary and proper course of Koza's business?

— Does the unprecedented and exceptional nature of an expense preclude it from being regarded as one made in the ordinary and proper course of business?

— Does the proposed expenditure give rise to a breach by Koza's directors of their fiduciary duties?

The High Court went on to assess each of the three proposed expenditures in turn, in light of the principles set out above.

The High Court quickly concluded that the fees paid by Koza to the public relations consultants and to its director were in the ordinary and proper course of business, having regard particularly to the reasonable nature of those expenses and the value for money they delivered.

In respect of the costs associated with the proposed arbitration proceedings, whilst the High Court affirmed that funding such proceedings could in theory fall within the definition of *"ordinary and proper course of business"*, it assessed the merits of the underlying dispute and concluded that expending those costs would not be within Koza's ordinary and proper course of business. The High Court pointed in particular to the facts that other sources of funding had not been explored properly, and that funding the proceedings may be in breach of the directors' fiduciary duties (having regard to the limited prospects of success).

Comment

This decision provides additional guidance on the meaning of *"ordinary course of business"*, and whilst the High Court's decision related to the language used in a bespoke court order, its conclusions might be relevant to M&A sale and purchase agreements where similar wording is often used concerning obligations relating to interim periods (and such like).

It seems that the following principles may be drawn from this decision:

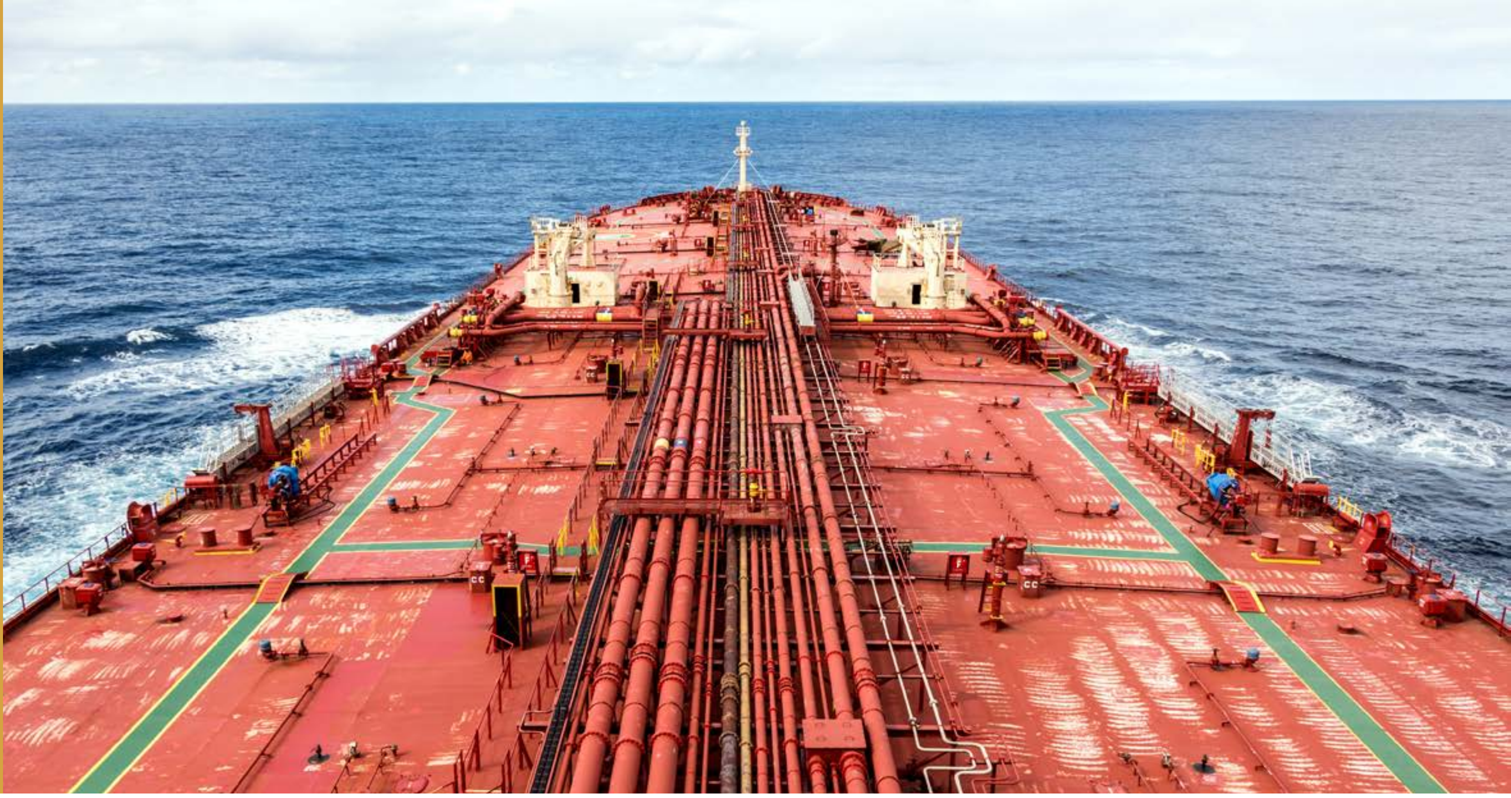
— Whether an expenditure is within the ordinary and proper course of business will likely be assessed objectively having regard to the specificities of the company and its business.

— The fact that an expenditure is unprecedented and/ or exceptional does not preclude it from being in the ordinary course of business.

— An expenditure that would cause the company's directors to breach their fiduciary duties will normally be outside of the ordinary course of business.

That said, the High Court also demonstrated that whether an expenditure is within the ordinary course of business is largely a question of fact and shall be assessed on a case-by-case basis. As such, caution should be adopted in deciding whether an expenditure is in the ordinary course of business.

Judge: Richard Spearman QC



Support Vessels and Shipping

The shipping side of the industry continues to turn up cases on a variety of issues that are of direct relevance to the oil and gas sector ranging from the interrelationship between differing oil company model terms and the impact of decisions of the Venezuelan courts on English law contracts.

- In *Seatrade Group NV v Hakan Agro DMCC, Re The Aconcagua Bay* [2018] EWHC 654 (Comm), the Commercial Court ruled, in an extremely succinct decision, that a warranty in a voyage charterparty that a berth is *"always accessible"* encompasses both entry to and exit from the berth.

- In *Lukoil Asia Pacific Pty Ltd v Ocean Tankers (Pte) Limited (Ocean Neptune)* [2018] EWHC 163 (Comm), the Commercial Court overturned an arbitral award concerning a charter incorporating standard terms of the ExxonMobil VOY2005 form and the Lukoil International Trading and Supply Company Exxonvoy 2005 Clauses. The Commercial Court decided that a claim by the owner concerning time 'waiting for orders' was a claim for demurrage and contractually time barred.

- In *ST Shipping and Transport PTE Ltd v Space Shipping Ltd* [2017] EWHC 2808 (Comm), the Commercial Court rejected an arbitration appeal that sought to argue that the actions of the Venezuelan courts, in openly not following Venezuelan law, broke the chain of causation so relieving the charterer of liability for a court-ordered detention.

The Aconcagua Bay – "always accessible"

In *Seatrade Group NV v Hakan Agro DMCC, Re The Aconcagua Bay* [2018] EWHC 654 (Comm), the Commercial Court decided, in an extremely succinct decision, that a warranty in a voyage charterparty that a berth is *"always accessible"* encompasses both entry to and exit from the berth.

Facts

The parties had entered into an amended GENCON 1994 standard form charterparty for carriage from the US Gulf to the Republic of Congo and Angola. The charterparty included a warranty for:

> *"10. Loading port or place (Cl.1)*
>
> *1 good safe berth always afloat always accessible..."*

Damage to a bridge and lock resulted in the vessel having to remain in its berth for 14 days after the completion of loading. The owners claimed damages for detention from the charterers for the period of this delay.

The Arbitration Award

At arbitration it was found that *"always accessible"* extends only to entry and not to departure, which meant the charterers were not in breach of warranty. This finding was consistent with other judgments and awards including London Arbitration 11/97 (although in that award the point was non-decisive).

Commercial Court Decision

The Commercial Court referred to various sources to which the 1997 tribunal did not have access, in particular the Baltic Code 2003 (and its 2007 and 2014 versions) which specifies where the charterer *"undertakes the berth will be always accessible, he additionally undertakes that the vessel will be able to depart safely from the berth without delay"*. The Commercial Court also noted that, while the Umpire in the present case had considered the dictionary definition of *"accessible"*, a dictionary could not resolve the point of interpretation.

The charterers accepted that *"always afloat"* refers to the duration of period alongside or in berth, and *"always accessible"* refers at least to entry, which led the Commercial Court to consider whether the omission of departure from berth was deliberate.

The Commercial Court considered that there was no basis to conclude that parties had only addressed entry when considering accessibility, and was persuaded by the owners' submission that the reasonable commercial party, looking at the subject of berthing, would *"bear all aspects in mind and not confine itself to getting to the berth"*.

Some charterparties use the words *"reachable on arrival"* and it is self-evident that this only applies to arrival. The Commercial Court therefore concluded that if the parties had intended to only refer to arrival they would have done so, meaning that *"always accessible"* must apply to both entry and departure.

Conclusion

Warranties that berths are *"always accessible"* are common in charterparties. This case provides important guidance on exactly what this means and should be considered accordingly by parties which have given, or are being asked to give, a warranty in these terms. Should parties intend to only warrant entry to a berth, this should be made clear in the drafting.

Judge: Knowles J

Is a waiting on orders claim subject to demurrage notification?

In *Lukoil Asia Pacific Pty Ltd v Ocean Tankers (Pte) Limited (Ocean Neptune)* [2018] EWHC 163 (Comm), the Commercial Court overturned an arbitral award concerning a charter incorporating standard terms of the ExxonMobil VOY2005 form and the Lukoil International Trading and Supply Company Exxonvoy 2005 Clauses dated 30 May 2006. The Commercial Court decided that a claim by the owner concerning time 'waiting for orders' was a claim for demurrage and contractually time barred.

Facts

In November 2013, Lukoil Asia Pacific Pty Limited (the '**Claimant**' or '**Charterers**') chartered the Ocean Neptune (the '**Vessel**') from Ocean Tankers (Pte) Limited (the '**Defendant**' or '**Owners**') for the carriage of petroleum products from one safe port in Taiwan to one to three safe ports in Australia. The voyage charter was contained in a fixture recap email which incorporated the standard terms of the ExxonMobil VOY2005 form and the Lukoil International Trading and Supply Company Exxonvoy 2005 Clauses dated 30 May 2006 (the '**LITASCO Clauses**'), as amended in the fixture recap with a laytime for loading and discharging of 84 hours in total at both ends, Saturdays and holidays included.


Clause 13 of the ExxonMobil VOY2005 form stated:

> *" 13. LAYTIME/DEMURRAGE*
>
> *….*
>
> *(d) PAYMENT. Charterer shall pay demurrage per running day and pro rata for a part thereof for all time by which the allowed laytime specified in Part I (I) is exceeded by the time taken for the loading and discharging and for all other Charterer's purposes and which, under this Charter, counts as laytime or as time on demurrage."*

Clause 2 of the LITASCO Clauses required (with underlining to illustrate where the Clauses were amended by the fixture recap):

> *"2. Claims*
>
> *A. …*
>
> *Unless a claim has been presented in writing to charterers with supporting documentation within ninety (90) days <u>for demurrage and 120 days for other claims</u> from completion of discharge of the cargo under this charterparty.*
>
> *B. For demurrage claims supporting documents must include <u>whenever possible</u> –*
>
> *1. Owners' calculation of the demurrage due; and*
>
> *2. The certificate of notice of readiness tendered at each port of loading and discharge; and*
>
> *3. The statement of facts for each loading and discharge berth which must be signed by the master or the vessel's agents and, wherever possible, the terminal; and*
>
> *4. The vessel's pumping logs for each discharge berth; and*
>
> *5. All letters of protest issued by the vessel or the terminal. The nor [sic]."*

Clause 4 of the LITASCO Clauses stated (with underlining to illustrate where the Clauses were amended by the fixture recap):

> *"4. Waiting for orders clause*
>
> *If charterers require vessel to interrupt her voyage awaiting <u>at anchorage</u> further orders, such delay to be for charterers' account and shall count as laytime or demurrage, if vessel on demurrage. <u>Drifting clause shall apply if the ship drifts</u>."*

Following receivers at one port in Australia (Gladstone) refusing to take delivery of cargo because the cargo was alleged to be off-specification/contaminated (this delay totalling around 1,048.58 hours), the Owners claimed demurrage together with interest and costs. The Charterers denied liability for the claim on the grounds, amongst others, that the claim was time barred because the documents in support of the claim specified in the LITASCO Clauses for demurrage were not provided within 90 days of the completion of discharge.

The Owners subsequently argued that time at Gladstone was, in fact, time waiting for orders. Further, such time was not demurrage.

The Arbitration Award

The arbitral tribunal agreed with the Owner's submission in relation to time bar for demurrage costs relating to delays caused at Gladstone. It accepted the Owners' claim that time lost waiting for orders fell under Clause 4 of the LITASCO Clauses, but that the time limitation for demurrage claims did not apply to time waiting on orders.

The arbitral tribunal's reasoning for that conclusion was contained in paragraph 20 of its award in the following terms:

> *"It seems to us that the strict application of the requirements of clause 2.B has to cut both ways and they are not applicable to a claim for time lost waiting for orders. Not only does that follow from the proper construction of the rider clauses, but from a practical point of view it would make sense for the documentary requirements for demurrage not to be applicable to claims for time lost waiting for orders. When a vessel has to wait for orders, she will often do so off port limits in order to avoid port charges. As a result, the contact that a vessel will have with the shore representatives of those handling the cargo may well be totally absent. The vessel's wait for orders may generate no communications at all with anyone at the port."*

In essence, the arbitral tribunal decided that there was a distinction to be drawn between claims for demurrage in relation to operational delays at the loading and discharge ports, and claims for time lost waiting for orders, which were to be treated differently. The fact that a LITASCO Clause 4 claim was to *"count as"* demurrage for the purposes of computation did not make it a claim for demurrage for all purposes, and in particular did not do so for the purposes of clauses such as LITASCO Clause 2B.

Commercial Court Decision

In overturning the arbitral tribunal's decision, the Commercial Court applied the usual principles of contractual interpretation and construction. In doing so, it considered the natural and ordinary meaning of the terms of the charter and the commercial consequences of rival constructions.

The starting point for the Commercial Court's analysis was that LITASCO Clause 2B applies *"for demurrage claims"*. The question for the Commercial Court was therefore whether a claim under LITASCO Clause 4 is a 'demurrage claim'. In this respect, the Commercial Court considered that the ExxonMobil VOY2005 form and the LITASCO Clauses are detailed and carefully drafted terms, and the fixture recap was framed by reference to them. It therefore found it convenient to start its analysis with the language used in the charter as a whole, before moving on to the commercial consequences. The Commercial Court reasoned:

— the language of the charter provides in clear terms that a LITASCO Clause 4 claim is a demurrage claim;

— identification of what is meant by a claim for demurrage is to be found in Clause 13(d) of the ExxonMobil VOY2005 form. It is there that the obligation to pay demurrage is framed by the use of the words *"Charterer shall pay demurrage..."*. It provides that demurrage is to be paid for all time by which the allowed laytime *"is exceeded by time taken for loading and discharging and for all other Charterer's purposes and which, under this Charter, counts as laytime or as time on demurrage"*;

— the language of LITASCO Clause 4 provides that the delay caused by waiting at anchorage shall *"count as"* used laytime or demurrage;

— the waiting time under LITASCO Clause 4 is, in the words of Clause 13(d), time taken for Charterers' purposes which under the Charter counts as laytime or demurrage. It therefore falls squarely within Clause 13(d), giving rise to a claim for demurrage;

— it follows that it is not just to be quantified in the same way as a demurrage claim at the demurrage rate. It is a demurrage claim under Clause 13(d). The words make it clear that there is no distinction between an 'ordinary' demurrage claim, in the sense of a claim where the Charterers have exceeded the allowed laytime by the time taken for loading and discharging, and a claim for delay waiting for orders where such delay is to count as laytime or time on demurrage. There is only one type of claim: a claim for demurrage to account for the time by which Charterers have exceeded the agreed laytime for loading, discharging and for any other of the Charterers' purposes which count as laytime or time on demurrage under the Charterparty – including time spent waiting for orders under LITASCO Clause 4;

— providing that time is 'to count' as laytime or demurrage and be treated as part of a demurrage claim is a common drafting technique in charterparty terms. The formulation is often used to describe periods which would otherwise not form part of the laytime;

— this construction is reinforced by the fact that a claim for waiting time under LITASCO Clause 4 is not simply or necessarily a claim for all such time. A claim under the Clause is not only to be quantified at the demurrage rate, but is also qualified by the laytime otherwise used or not used in the course of performance of other parts of the voyage. If a claim arises under the Clause it is to count as laytime: to the extent that laytime has not otherwise been used;

— this construction was also supported by the contrast between the wording of LITASCO Clause 4 and that of Clauses 5 and 7 of the fixture recap. Where the parties wanted to draw a distinction between demurrage claims and other types of delay claim they used clear language to do so. For example, Clause 5 provides that any delay caused by breach of the International Ship and Port Facility Security Code clause obligations by the Charterers *"shall be compensated at the demurrage rate"*; and

— the above construction makes commercial sense as such clauses are intended to enable the parties to have final accounting as swiftly as possible and, if any factual enquiries have to be made, to ensure that the parties are able to do so whilst recollections are reasonably fresh. This rationale applies as much to a claim for waiting time under LITASCO Clause 4 as to any other aspect of a demurrage claim.

Comment

Contractual notice and limitation periods are designed to provide parties with greater certainty as to the financial outcome of their transaction, by ensuring that any claims are speedily notified, substantiated and resolved.

However, it is important that the parties are aware of the existence of such provisions. In the absence of such compliance, English law will usually enforce the intention of the parties, objectively ascertained, by time barring any claim that might have otherwise been valid.

The deployment of multiple model form agreements, along with amendments, within a single contract, or charter, might make identifying the existence or meaning of such provisions more complex. However, the complexity of the exercise will not prevent English law from ascertaining the proper meaning of the contract, or charter, and applying its terms. Upon identifying a notice or limitation provision, if it is not clear whether a notice provision applies, swift legal advice should be sought, and consideration given as to whether a 'protective' notice should be issued 'without prejudice' to the contention on whether the provision properly applies.

Judge: Popplewell J

A Venezuelan detention

In *ST Shipping and Transport PTE Ltd v Space Shipping Ltd* [2017] EWHC 2808 (Comm), the Commercial Court rejected an arbitration appeal that sought to argue that the actions of the Venezuelan courts, in openly not following Venezuelan law, broke the chain of causation so relieving the charterer of liability for a court-ordered detention of a vessel as part of a criminal investigation that included issues of exporting without the permission of Petróleos de Venezuela S.A. ('**PDVSA**', a Venezuelan state-owned oil and gas company).

The case gives an interesting insight as to country risk arising from decisions of local courts.

Facts

ST Shipping and Transport PTE Ltd (the '**Claimant**' and the '**Charterer**') and Space Shipping Ltd (the '**Defendant**' and the '**Disponent Owners**') entered into a charterparty dated 10 April 2014 on an amended Shelltime 4 form in respect of the vessel CV STEALTH. On the 19 September 2014, the vessel was detained by order of the Venezuelan court when waiting to load cargo under an employment order dated 4 September 2014 given by the Charterer to the Disponent Owners. The Venezuelan court had prohibited the ship from sailing from Puerto La Cruz as a precautionary measure to assist in the investigation into alleged crimes of a Mr Barbosa.

Mr Barbosa was subsequently charged with several criminal offences including the forgery of an authorisation purporting to come from PDVSA and with attempting to export cargo without the necessary authorisation of PDVSA. No allegations were made by the Venezuelan prosecutor against the Charterer or Disponent Owners. In late autumn 2014, the Disponent Owners filed a petition to lift the prohibitive order but the Venezuelan court refused to let the vessel sail. There were then various applications for the release of the vessel, appeals and arbitration.

The Disponent Owners commenced arbitration against the Charterer concerning the financial consequences of the detention of the vessel.

During arbitration in 2015, it was decided that any final assessment of trading losses resulting from the ship's detention would be deferred and instead partial arbitral awards should be made. The arbitrator decided in his First Partial Final Award, dated 23 September 2015, that the employment order was the cause of detention of the vessel and that the Charterer was financially liable to the Disponent Owners for the financial consequences of the detention up to July 2015, pursuant to an express indemnity and as damages for breach of the charterparty.

The Charterer then unsuccessfully appealed to the English High Court, which upheld the arbitrator's decision. The Venezuelan court continued to refuse release of the vessel between July 2015 and the beginning of 2017, despite the Prosecutor's office requesting its release. Under the arbitrator's Fourth Partial Final Award in relation to the matter dated 25 May 2017, it was held that, despite the Venezuelan court's behaviour, the employment order could still be said to be the cause of the continued arrest of the vessel and the Disponent Owner's continuing trading losses up to 31 March 2017.

The Charterer sought to appeal against the Fourth Partial Final Award.

Decision

The key issue before the Commercial Court was whether the Charterer's employment order could still be said to be the cause of the continued arrest of the vessel – the Charterer arguing that the cumulative effect of unreasonable conduct by the Venezuelan judiciary in the period from 2015 had broken the chain of causation.

The Commercial Court decided there was no misapplication or misunderstanding of the legal causation test on the part of the arbitrator and refused the Charterer's appeal in relation to losses after July 2015 under section 69 of the Arbitration Act 1996 (the '**Act**').

There was little dispute between the parties as to the relevant legal test of causation. The issue in the Charterer's appeal is simply whether the arbitrator has applied a different one. In particular:

- The question is whether the employment order was an effective cause of the continued detention; it need not be the cause, i.e. the sole cause; but an effective cause is more than a 'but for' cause, which does no more than provide the occasion for some other factor unrelated to the Charterer's order to operate: *ENE Kos 1 Ltd v Petroleo Brasileiro SA ('**The Kos**')* [2012] 2 AC 164.
- Once an effective cause is operative, it will only be replaced by another intervening cause, so as to render the latter the sole effective cause, if the intervening act constitutes an event of such impact that it *"obliterates the wrongdoing"*: *Borealis v Geogas Trading* [2011] 1 Lloyd's Rep 482.

In reaching its decision the Commercial Court reiterated the key 'well-established' principles of legal causation:

- Where various factors or causes are concurrent, and one has to be selected as an effective cause, the matter is determined as one of fact: *Leyland Shipping v Norwich Union* [1918] A.C. 350, quoted with approval in *ENE Kos 1 Ltd v Petroleo Brasileiro SA (The Kos)* [2012] 2 AC 164.

— Where the arbitrator has selected one cause in preference to another as the direct or proximate cause, that is a decision of fact: *Royal Greek Government v Minister of Transport ('**The Ann Strathatos**')* (1949) 83 Lloyd's Rep 228 per Devlin J at 238, quoted with approval in *The Kos*.

— However if an arbitrator has misdirected himself on a principle of law that is an error of law: see *The Ann Strathatos*.

— If the arbitrator could not have reached the conclusion to which he came on the facts had he applied the correct principles of law, there must have been an error of law either in failing to identify the correct principles of law or in failing to apply them: *Fulton Shipping Inc of Panama v Globalia Business Travel SAU* [2017] 2 Lloyd's Rep 177.

In essence, the Charterer argued that the arbitrator had applied as a legal test of causation the question whether anything had changed since the First Partial Final Award and that this was not the correct question. The arbitrator concluded that it had not, because what had happened since 21 July 2015 was more of the same, so that the findings of causation in that First Partial Award still applied. This, the Charterer argued, was an error of law because it was necessary to consider the cumulative effect of intervening unreasonable acts when considering whether those unreasonable acts have broken the chain of causation.

The Commercial Court rejected this argument as:

— In his First Partial Final Award the arbitrator referred to *The Kos* and expressly adopted the test as being whether the employment order was an effective cause of the detention in respect of the period he was then considering, namely to 21 July 2015. He was plainly aware of the relevant test, and it would be most surprising if he had forgotten it or chosen to apply a different test in his Fourth Partial Final Award. There is nothing in the language he used to suggest that he did so.

— The arbitrator had already decided that the employment order had causative potency up to 21 July 2015. The focus was on whether what had happened since was sufficient to break the chain of causation. It is not therefore a matter of criticism that he should have focused on what had changed.

— The fact that the approach and attitude of the Venezuelan courts had not changed from the time at which the arbitrator had held the employment order to be of causative potency, could legitimately be taken as powerful evidence that the latter remained of causative potency and that the causative chain had not been broken. That was the factual conclusion reached by the arbitrator.

— If there were any doubt about it, it is dispelled by the reference in the arbitrator's award to the difference in subsequent judicial behaviour being insufficient to *"obliterate the original cause of the detention"*. This reflects the language of the test in *Borealis v Geogas*, which the arbitrator clearly had in mind.

— In truth, the Charterer's appeal was an example of trying to dress up an appeal against findings of fact as one which turns on questions of law, which it is the policy of the Act to prevent.

Comment

The decision of the Commercial Court illustrates that it is difficult to 'break the chain of causation' once an initial effective cause is established.

In the context of actions before local courts, this might prove an interesting issue. As with the English courts, many international courts are well practised in granting protective measures to prevent potential crimes or potential civil wrongs that might disturb the *status quo* pending trial. If the employment of a vessel by the Charterer results in a court ordering the detention of the vessel, it is apparent from this decision that it will be difficult to establish that subsequent actions by the court in refusing to lift such order (rightly or wrongly), when the order is revisited for further consideration, will break the chain of causation.

The risk of alleged misapplication of the law by local courts is substantial in some jurisdictions, so might constitute a significant risk to the party taking liability for vessel detention due to local court order. If possible, such risks should be understood and accounted for at the time of agreeing any charter.

Judge: Popplewell J

Drilling Units

The recently volatile market for rig rates has continued to generate interesting cases concerning alleged wrongful termination of drilling unit contracts over the past 12 months. In addition, the increasingly complex relationships between parties involved in leasing drilling units have resulted in an interesting case concerning the identity of a party to a contract for upgrade works:

— In *Seadrill Ghana Operations Limited v Tullow Ghana Limited* [2018] EWHC 1640 (Comm), Tullow Ghana Limited sought to defend its termination of a contract for hire of a drilling rig in reliance on the contract's force majeure clause. The Commercial Court decided that Tullow was not entitled to rely on the clause and ordered Tullow to make payment of approximately USD 254m.

— In *Vantage Deepwater Company and Vantage Deepwater Drilling, Inc. v Petrobras America Inc.; Petrobras Venezuela Investments & Services, BV; and Petróleo Brasileiro S.A. (Petrobras Brazil),* an arbitral tribunal awarded USD 615.62m against Petrobras for wrongfully terminating a drilling services agreement for 'material breach' and other alleged reasons. The case serves as a reminder that the concept of 'material breach' is not straightforward and there are significant risks in terminating such agreements without establishing proper cause.

— In *Kaefer Aislamientos SA de CV v AMS Drilling Mexico SA de CV, Atlantic Marine Services BV, Atlantic Tiburon 1 Pte Limited, Ezion Holdings Limited* [2017] EWHC 2598 (Comm), the Commercial Court rejected an argument that a rig owner, and/or its parent company, were party to a contract between a charterer of the rig and a third party to carry out works to upgrade the rig. The case is an important reminder of the importance of contracting with the proper party in the context of supply chains where company groups and joint venture partners might act through a variety of corporate structures.

Drilling down into termination for force majeure

In *Seadrill Ghana Operations Limited v Tullow Ghana Limited* [2018] EWHC 1640 (Comm), Tullow Ghana Limited ('**Tullow**') sought to defend its termination of a contract for hire of a drilling rig with Seadrill Ghana Operations Limited ('**Seadrill**') (the '**Contract**') in reliance on the Contract's force majeure clause. The Commercial Court decided that Tullow was not entitled to rely on the clause in that way and ordered Tullow to make payment to Seadrill of approximately USD 254m. Tullow has publicly stated it is examining its options, including seeking leave to appeal the judgment.

Facts

Tullow had interests in two offshore petroleum licences or concessions about 60kms off the coast of Ghana. One, known as West Cape Three Points, included the Jubilee oilfield ('**Jubilee Field**'), which was considered to be a 'flagship asset'. The other, known as Deepwater Tano, included three oilfields collectively known as TEN (Tweneboa, Enyenra and Ntomme) ('**TEN**'). Tullow was the operator of both TEN and Jubilee on behalf of joint venture partners and the concessions were granted by the Government of Ghana. The West Cape Three Points concession also included other oil fields (referred to as '**MTA**') operated by another oil company Kosmos, one of Tullow's joint venture partners. Tullow's intention was to replace Kosmos as the operator of MTA and to obtain approval from the Government of Ghana to a plan for the development of MTA, known as the Greater Jubilee Full Field Development Plan (the '**Greater Jubilee Plan**').

Tullow hired from Seadrill a 6th generation ultra deepwater semi-submersible rig (the '**Rig**'), West Leo, under the Contract. The Contract required Tullow to pay a daily operating rate in the sum of USD 600,000.

Section 2(A), Clause 1.1.4 of the Contract defined the *"Contract Area"* as Tullow's *"concession area and any area used in association therewith"*. There was no dispute between the parties that the concession areas were Deepwater Tano and West Cape Three Points for the purposes of the Contract.

Section 2(A), Clause 27.1 of the Contract read as follows:

> *"27.1 Neither COMPANY nor CONTRACTOR shall be responsible for any failure to fulfil any term or condition of the Contract if and to the extent that fulfilment has been delayed or temporarily prevented by an occurrence, as hereunder defined as FORCE MAJEURE, which has been notified in accordance with this Clause 27 and which is beyond the control and without the fault or negligence of the party affected and which, by the exercise of reasonable diligence, the said party is unable to prevent or provide against. Both parties shall use their reasonable endeavours to mitigate, avoid, circumvent, or overcome the circumstances of FORCE MAJEURE.*
>
> *27.2 For the purpose of the Contract, Force majeure shall be limited to the following:*
>
> *… (h) Drilling moratorium imposed by the government*
>
> *… 27.5 In the event of force majeure occurrence, the party that is or may be delayed in performing the Contract shall notify the other party without delay giving the full particulars thereof and shall use all reasonable endeavours to remedy the situation without delay.*
>
> *… 27.8 In the event that a FORCE MAJEURE condition prevails for a period of sixty (60) consecutive days then COMPANY may terminate the CONTRACT forthwith by giving notice, or may elect keeping CONTRCATOR* [sic] *under CONTRCT* [sic] *and keep paying the DAILY FORCE MAJEURE RATE."*

In September 2014, Ghana and Cote d'Ivoire entered into an arbitration pursuant to the United Nations Convention on the Law of the Sea to resolve a dispute between them as to precisely where the offshore boundary between the two states lay. Cote d'Ivoire was successful in seeking a Provisional Measures Order ('**PMO**') containing an order to the following effect: *"Ghana shall take all necessary steps to ensure that no new drilling either by Ghana or under its control takes place in the disputed area"*. Part of the disputed area included TEN. The effect of the PMO meant that, whilst completion of spudded wells could continue in TEN, no new wells could be spudded.

Tullow had several wells that were in the process of being spudded, with the last such well due to be completed in September 2016. Once these were completed, Tullow intended to use the Rig for the purposes that it would be used in the Greater Jubilee Field (upon the assumption that approval had been given by the Government to the Greater Jubilee Plan).

However, a technical problem also arose on the FPSO being used in the Jubilee Field in February 2016, the consequence of which meant, according to Tullow, Ghana was unwilling to approve the Greater Jubilee Plan.

Tullow sought to rely on the issuance of the PMO as the force majeure event under the Contract, which prevented it from issuing drilling instructions to Seadrill (which Tullow argued was an obligation under the Contract) and ultimately allowed it to terminate the Contract.

However, Seadrill contended that Tullow's refusal to pay hire was not unconnected with the collapse in the oil price in 2014 which led to a reduction in demand for rigs such as West Leo and, in consequence, to a substantial reduction in the daily market rate of hire for such rigs, from about USD 600,000 per day to USD 150,000 to USD 200,000 per day at the end of 2016.

Decision

The Commercial Court considered two overarching issues:

- Whether the cause of Tullow's failure to comply with its obligations under the Contract in October 2016 was a force majeure, namely, a drilling moratorium imposed by the Government of Ghana; and
- if the answer to the first issue was found to be affirmative, whether Tullow had exercised its reasonable endeavours to remedy or avoid the force majeure.

In deciding the first issue, the Commercial Court found that:

- First, a letter issued by the Government of Ghana in May 2015 with a clear expectation that Tullow was to comply with the PMO, was sufficient to constitute a moratorium of drilling was imposed by the Government (despite the lack of a formal order or direction).
- Second, notwithstanding Tullow's ability to continue spudding existing wells until September 2016, the Commercial Court found that with respect to timing, the moratorium was imposed when such letter was sent, in May 2015 even though it did not 'bite' on West Leo until October 2016.
- Third, in relation that a force majeure must relate to a *"failure to fulfil any term or condition of the Contract"*, it was arguable that, if is assumed that Tullow intended to issue a drilling programme but was prevented from doing so because of a drilling moratorium imposed by the Government, Tullow could say that it had failed to fulfil a term of the Contract (namely, Section 2(A), Clause 18.1 which required it to provide Seadrill with a drilling programme). However, Tullow appeared to have discretion of whether to issue such programme.
- Fourth, Tullow was not correct in its argument that the only question was said to be whether the moratorium was a force majeure. Section 2(A), Clause 27.1 of the Contract requires Tullow to have been prevented from or delayed in fulfilling its obligations by an occurrence which is a force majeure. Therefore, there is a clear causation requirement between the force majeure and Tullow's failure to provide drilling instructions to Seadrill.
- Fifth, in relation to whether the moratorium was the cause of Tullow's inability to issue a drilling programme, both the moratorium and the failure of the Government to approve the Greater Jubilee Plan were, on a broad common sense view of the position, causative of Tullow's inability. Tullow expected to gain approval for the Greater Jubilee Plan and it was not open to Tullow to argue that Tullow never had the right to do any work in the Greater Jubilee Field pending approval. There were, therefore, two effective causes of Tullow being unable to provide drilling instructions in October 2016, one being a force majeure, and the other not.
- Sixth, the Court of Appeal decided in *Intertradex v Lesieur* [1978] 2 Lloyd's Reports 509 that where two causes operated to prevent a seller from shipping goods a force majeure notice had to be given in respect of each of them. Where notice had only been given of one the seller could not rely upon the force majeure clause. That decision is regarded as one which establishes the proposition that a force majeure event must be sole cause of the failure to perform an obligation (see Frustration and Force Majeure by Sir Guenter Treitel, 3rd.Ed at paragraph 12-032).

As such, in relation to the first issue, Tullow failed to establish force majeure, as one effective cause of its inability to issue a programme was not a force majeure event.

In deciding the second issue, although the Commercial Court accepted that the issue no longer strictly arose due to Tullow's failure on the force majeure issue, the Commercial Court decided that Tullow ought, but failed, to provide Seadrill with drilling instructions with respect to certain wells in the Jubilee Field. In particular, Tullow's failure to take remedial steps on the basis that they were less technically straightforward or came at a cost was considered insufficient, as it resulted in a failure by Tullow to consider the interests of Seadrill alongside its own. The Commercial Court confirmed that failure by Tullow to exercise reasonable endeavours was a further reason why Tullow was unable to rely on the force majeure clause.

Tullow was ordered to make payment to Seadrill of approximately USD 254m.

Comment

The English courts remain cautious of oil companies terminating drilling unit contracts for alleged breach or force majeure at times that the rig rate has fallen. This case is one of a list of cases in which, over many years, the English courts have found against oil companies seeking to terminate in such circumstances. As such, oil companies should remain cautious when terminating drilling unit contracts in a falling market.

In addition, this case highlights a number of drafting issues that parties should keep in mind when drafting drilling unit contract force majeure terms:

- In the event that part of the definition of force majeure is *"any failure to fulfil any term or condition of the Contract"*, it might prove difficult for an oil company to claim force majeure, as its performance obligations under the drilling unit contract might be limited. In this case, the Commercial Court seemed to doubt that Tullow had failed to perform any contractual obligation, as the issuing of drilling programmes might have been discretionary.
- Unless drafted otherwise, concurrent hindrances on performance, one of which constitutes force majeure and one that does not, will generally not result in force majeure clause being satisfied. If such concurrent causes are intended to result in the force majeure provisions of the contract applying to excuse performance, it would be wise to use specific drafting to achieve this end. In this case, the Commercial Court found that concurrent hindrances on performance meant that there was no force majeure.
- In this respect, if a failure to provide a drilling programme or location is to be a class of 'breach', which if caused by a force majeure event is to trigger the force majeure clause, an oil company may wish the scope of works in the contract to be carefully defined by location to ensure that the clause is triggered. A force majeure clause will usually not be interpreted as being applicable where alternative methods of performance still exist. In many occasions, it will be permissible under the drilling unit contract for the oil company to programme or instruct drilling in another location – resulting in no force majeure arising.

Finally, this case acts as a reminder that all notice provisions should be strictly complied with. When relying on a claim of force majeure to exclude liability for performance of obligations under a contract it is necessary to ensure that notice(s) cover all events that might be the cause of the force majeure.

Termination Provisions in Drilling Contracts

In *Vantage Deepwater Company and Vantage Deepwater Drilling, Inc.* (together '**Vantage**') *v Petrobras America Inc.; Petrobras Venezuela Investments & Services, BV; and Petróleo Brasileiro S.A.* (Petrobras Brazil) (together '**Petrobras**') an arbitral tribunal awarded USD 615.62m against Petrobras for wrongfully terminating a drilling services agreement for 'material breach' and other alleged reasons. The case serves as a reminder that the concept of 'material breach' is not straightforward and there are significant risks in terminating such agreements without establishing proper cause.

Facts

The dispute concerned a drilling services agreement entered into between Vantage and Petrobras on 4 February 2009 (the '**Contract**') and which was novated on three separate dates: 18 April 2012 (the '**First Novation**'), 20 December 2013 (the '**Second Novation**'), and 27 October 2014 (the '**Third Novation**'). The original Contract and the First and Second Novations were governed by English Law. The Third Novation was governed by the Laws of the State of Texas. The arbitration agreement was to be governed and construed under the laws of Texas, therefore, all procedural matters were governed by Texan law.

The Contract provided for an eight year lease which was expected to run until December 2020. The termination provisions provided:

> *"Clause 9.1 Termination*
>
> *This Contract shall terminate without notice at the end of the Term or any extension thereof. In addition to the foregoing, and notwithstanding any other provision of this Contract, this Contract may only be terminated:*
>
> *By COMPANY, for the following reasons:*
>
> *....9.1.1.2*
>
> *if any relevant CONTRACTOR item suffers substantial structural damage or major breakdown not caused by Company, (a "Material Breakdown"), unless CONTRACTOR has sent written notice to COMPANY within five (5) days following occurrence of the Material Breakdown that it elects to remedy such Material Breakdown, and such remedy, in the reasonable opinion of COMPANY, can be effected within a period of one hundred and eighty (180) days from the date of such notice, (each a "Material Breakdown Suspension Period"); provided, however, that COMPANY may terminate this Contract at any time following the expiration of the Material Breakdown Suspension Period if the Material Breakdown is not cured to the satisfaction of COMPANY prior to such expiration. For avoidance of doubt, the remedy of such Material Breakdown shall not be considered as a repair of the Drilling Unit and CONTRACTOR shall not be entitled to receive any Daily Rate or reimbursement for the period commencing upon the date of such Material Breakdown and ending upon the date such Material Breakdown is remedied to the satisfaction of COMPANY;*
>
> *9.1.1.3*
>
> *if CONTRACTOR commits a material breach of its obligations under this Contract.*

...9.1.1.7

if CONTRACTOR repeatedly fails to conduct the Services in accordance with Good Oil and Gas Field Practices; or

...9.1.3

By either Party:

...9.1.3.2

if any of the other Party's representations and warranties are false in any material respect; provided however, CONTRACTOR shall not have the right to terminate the Contract under this Clause for COMPANY's inability to secure COMPANY's Authorizations in which case COMPANY shall nominate an alternative Country of operation.

Clause 9.2: Termination for convenience

9.2.1 COMPANY shall not be entitled to terminate this Contract for convenience."

On 31 August 2015, Petrobras terminated the Contract. The termination of the Contract left a term of around five years and three months to run. In essence, Petrobras argued that Vantage was in material breach by repeated failures in Good Oil and Gas Field Practices in at least three ways:

— By failing to properly monitor volumes, detect losses and give proper notice.

— By violating applicable law.

— By failing to follow its own policies and procedures.

Vantage initiated arbitration for wrongful termination and sought damages. According to Vantage, Petrobras terminated the Contract, in effect, for convenience as a response to deteriorating market conditions, and failed to negotiate in good faith.

In addition, Petrobras asserted various counterclaims alleging that the Contract was void, voidable, unconscionable and had to be rescinded, since it had been unduly awarded through illegal payments made or offered to Petrobras officials with Vantage's knowledge, unknown to Petrobras, for the purpose of inducing the entry into of the Contract.

Decision

The arbitral tribunal found in favour of Vantage and ordered Petrobras to pay USD 615.62m in relation to the wrongful termination of the Contract.

The majority of the arbitral tribunal found that Petrobras had not proved a material breach of contract that justified termination of the Contract. The meaning of 'material breach' had not been defined in the Contract. However, the arbitral tribunal referred to the definition in the Contract of *"material breakdown"* which provided that *"material"* means something *"substantial"* and *"major"*. The arbitral tribunal considered that Petrobras had not acted reasonably in refusing to accept the proposed cures for the fluid loss events that it had sought to use as the basis for termination of the Contract. Further, even if the fluid loss events were Vantage's fault, the arbitral tribunal considered that they were not sufficient to trigger a right of termination. In its reasoning, the arbitral tribunal considered it relevant that neither Petrobras nor the Bureau of Safety and Environmental Enforcement had considered the fluid loss events to be 'serious' at the time.

Petrobras had also sought to argue that Vantage did not perform in accordance with *"Good Oil and Gas Field Practices"*. However, the arbitral tribunal considered that it was more likely than not that the referred fluid loss events were caused by Petrobras actions, rather than Vantage's violations of Good Oil and Gas Field Practices.

In terms of the corruption and bribery allegations, the arbitral tribunal considered that Petrobras did not prove with clear and convincing evidence that illicit payments had been made to Petrobras officials with Vantage's knowledge.

Without deciding on the merits of the bribery allegation, the arbitral tribunal decided that Petrobras could not rely on a bribery defence because it had knowingly ratified the Contract in the First and Second Novations. In fact, the arbitral tribunal noted that when the Second Novation and Third Amendment were entered into, Petrobras was aware of the bribery allegations and yet continued with the Contract. Also, the Second Amendment and First Novation were formed without the involvement of anyone who was alleged to have been involved in bribery.

The dissenting arbitrator refused to sign the final award on the basis that Petrobras had been denied the fundamental fairness and due process protections it should have been entitled to in the arbitration.

Petrobras has indicated that it intends to appeal the decision. Given that the seat of arbitration is Texas, the appeal will also be held in Texas.

Commentary

As explained in our commentary on *Seadrill Ghana Operations Limited v Tullow Ghana Limited* [2018] EWHC 1640 (Comm), the English courts remain cautious of oil companies terminating drilling unit contracts for alleged breach or force majeure at times when market rig rates have fallen. This arbitral award suggests that arbitrators exhibit the same caution.

The decision of the arbitral tribunal demonstrates the importance of accurately defining the meaning of 'material breach' in agreements and/or understanding its true meaning in the relevant contractual context. Interestingly, it is not apparent the extent to which English court authority on the meaning of 'material breach' in similar termination provisions was brought to the arbitrators' attention.

In *Dalkia Utilities Services plc v Celtech International Limited* [2006] EWHC 63 (Comm), the parties agreed that it must mean something less than a repudiatory breach or it would add nothing to the parties' common law rights. However, they could not agree on what it did mean. The Commercial Court identified that many authorities refer to 'material breach' as something more than a trivial or minimal breach. Also, in deciding the meaning of 'material breach' the Commercial Court should have regard to the contractual consequences of material breach occurrence. As a consequence, it may be that the arbitrators applied a higher threshold to establishing a right of termination than previous English law cases would suggest.

In this case, the arbitral tribunal resorted to the meaning of *"material"* in a clause of the Contract relating to *"material breakdown"*. As demonstrated by the arbitral tribunal's interpretation, the difficulty with the use of the term 'material' is that the relevant court or tribunal will have a degree of discretion in making its decision, which may leave the parties in a position of uncertainty when assessing the merits of issuing a notice of termination.

In relation to the allegations of corruption, under the Contract, the parties had agreed to follow the US Foreign Corrupt Practices Act 1977. In the UK, the applicable anti-corruption legislation is the UK Bribery Act 2010, which has been in force since July 2011. Together, the US Foreign Corrupt Practices Act and the UK Bribery Act 2010 are considered to be the most expansive forms of anti-bribery legislation in terms of illegal activities and jurisdictional reach.

In this case, the fact that there had been a novation of the Contract at a date after Petrobras realised that the Contract may have been obtained by illicit methods was of importance. If at any point a party realises there has been any form of corruption that could taint the contract, it should follow all of the steps required under the relevant legislation and contractual mechanism. The arbitral tribunal considered that the Contract would be voidable by the innocent party however it would not be automatically void. This would mean that if Petrobras had succeeded in arguing that the Contract had been procured by bribery it could have avoided the Contract, however, there was no requirement under English law to refuse to enforce the Contract.

This case again demonstrates that companies should exercise caution when terminating drilling unit contracts in a falling market, as arbitral tribunals and courts might suspect ulterior motives and be slow to accept that termination provisions have been properly invoked.

Arbitral Tribunal: James M. Gaitis, Esq., William W. Park, and Judge Charles N. Brower.

Drilling Units: are rig owners undisclosed principals?

In *Kaefer Aislamientos SA de CV v AMS Drilling Mexico SA de CV, Atlantic Marine Services BV, Atlantic Tiburon 1 Pte Limited, Ezion Holdings Limited* [2017] EWHC 2598 (Comm), the Commercial Court rejected an argument that a rig owner, and/or its parent company, were party to a contract between a charterer of the rig and a third party to carry out works to upgrade the rig. This case is an important reminder of the importance of contracting with the proper party in the context of supply chains where company groups and joint venture partners might act through a variety of corporate structures.

Facts

Atlantic Tiburon 1 Pte Limited ('**AT1**') was the registered owner of the cantilever jack-up rig Atlantic Tiburon 1 (the '**Rig**'). AT1 was a 100% subsidiary of Ezion Holdings Limited ('**Ezion**').

In early 2012, representatives of the parent company of AMS Drilling Mexico SA de CV ('**AMS Mexico**') and Atlantic Marine Services BV ('**AMS**'), Treatmil Holdings Ltd (Treatmil) and an associated company Traxiar Ventures Ltd ('**Traxiar**'), approached Ezion about a transaction by which Ezion would assist in providing rigs for projects with oil majors. Ezion would arrange financing and would purchase a rig through a special purpose vehicle ('**SPV**'), which in turn would demise charter the rig to AMS or a nominee company. The financing costs were to be reimbursed through the payment of charter hire income paid to the SPV from the earnings made by Treatmil and Traxiar; that income was to be paid into an escrow account.

One opportunity falling within this transaction was a contract with Pemex Exploracion y Production ('**PEP**') to operate the Rig as a drilling platform in the Gulf of Mexico. AMS entered into a contract with PEP (the '**PEP Contract**'), under which AMS was required to deliver the Rig to PEP between 30 May 2012 and 31 January 2015.

On 29 March 2012, AT1 entered into a contract for the purchase of the Rig. A Provisional Certificate of Registry was issued by the Republic of the Marshall Islands naming AT1 as the sole owner of the Rig on 24 April 2012.

On 16 March 2012, a bareboat charterparty (the '**Bareboat Charterparty**') was concluded in respect of the Rig between AT1 as owner and AMS as charterer. Works were required to enable the rig to be fit for service as a drilling platform in the Gulf of Mexico pursuant to the PEP Contract.

Kaefer Aislamientos SA de CV ('**Kaefer**') carried out the necessary works, including the removal and disposal of various items, the abatement of asbestos, the supply and installation of insulation, and refurbishment. It averred that it did so in accordance with a contract evidenced by a Purchase Order dated 16 August 2013 (the '**Purchase Order**' or the '**Contract**'). The Purchase Order identified Kaefer as the 'Vendor' and was signed by Mr Jody Baker of Atlantic Marine as 'the Company'.

The Contract contained an English exclusive jurisdiction clause. A dispute arose over the works and Kaefer sought USD 2,353,794.42 in unpaid sums.

The issue was whether the Contract was concluded by AMS as agent for AT1 as an undisclosed principal, so that the Contract and the jurisdiction clause were binding on AT1; and whether the Commercial Court had jurisdiction on the basis of the exclusive jurisdiction clause.

Decision

For a party to be an undisclosed principal:

- the agent must have contracted with and within the scope of the actual authority of the undisclosed principal;
- at the time of the relevant contract, the agent must have intended to contract on the principal's behalf; and
- there must be nothing in the contract or in the surrounding circumstances which shows that the agent is the true principal and which effectively excludes the making of a contract with an undisclosed principal.

There was nothing in the nature of the contractual services provided by Kaefer, or in the description of the other parties as *"the company"*, which necessarily excluded the possibility that the Contract was made with an undisclosed principal. There would usually have to be 'something more', such as an express provision prohibiting the intervention of an undisclosed principal or a contract which concerns the registered title of a named party.

Neither the Contract, nor the circumstances surrounding the Contract, indicated any desire on Kaefer's part not to contract with an undisclosed principal. Accordingly, in order to exercise jurisdiction in respect of the claim, the court had to be satisfied that: (i) AMS and/or AMS Mexico was actually authorised by AT1 and/or Ezion to conclude the Contract; and (ii) AMS and/or AMS Mexico intended, at the time of the Contract, to contract with the claimant on behalf of AT1 and/or Ezion as undisclosed principal.

There was no evidence that AT1 and/or Ezion had authorised AMS and/or AMS Mexico to contract on their behalf with Kaefer, or that AMS and/or AMS Mexico intended to contract on behalf of AT1 and/or Ezion had authorised such as to render AT1 and/or Ezion an undisclosed principal to the Contract.

Whilst, there was a good arguable case that AT1 was a party to the Contract as an undisclosed principal because it owned the Rig (and would receive indirect income from its use by third parties) and because AMS had referred to itself in a letter to the main contractor as the *"appointed representative of the asset owners"*, on balance the better argument was that AT1 was not an undisclosed principal. AMS was the charterer and the works were required to enable it to fulfil its third party contract in the Gulf of Mexico.

Ezion was merely the owner of AT1 and the fact that it was not prepared to own the Rig directly or to enter into the Bareboat Charterparty with AMS, renders it implausible that Ezion authorised AMS to contract on its behalf.

Therefore, AT1 and/or Ezion did not contract as undisclosed principal and the Commercial Court lacked jurisdiction to try the claim against it.

Comment

In the oil and gas industry, the practice of disclosing such principal/agency to third parties varies. For example, JOAs based upon the OGUK Model JOA require the operator to disclose the fact that it is acting as agent in its contracts (see Clause 8.1.1). However, the OGUK Model JOA goes further and attempts to short circuit any debate about the liability of co-venturers: the operator is required to include a provision in its contracts to the effect that notwithstanding the disclosed agency, any rights and duties arising out of the contract may be claimed against or made by the operator alone (see Clause 6.5.8). Such a provision is also common in the LOGIC standard procurement contracts (see, for example, Clause 26.5 of the LOGIC 1997 Drilling Contract).

The case may have more of an impact lower down the supply chain, especially in the context of contracts governing work on or for vessels or rigs. A party contracting for such work can be faced with a range of vessel or rig counterparties, for example the owner, the charterer or a ship manager. In many cases, these various entities with an involvement in the vessel or rig are members of the same group.

Quite which entity will be used by the vessel or rig group will likely be governed by considerations of tax and the spread of risk throughout the group. As such, most supply chain contracts involving vessels or rigs will be bilateral and are clearly intended to be entered into by principals.

Importantly, the Commercial Court decided that although AMS was identified as *"the company"* under the Contract, that, in and of itself, was not enough to preclude the undisclosed principal being a party to the contract. Something more was necessary and the example given was to include *"an express provision prohibiting the intervention of an undisclosed principal"*.

Since the ability to allocate contracts to particular entities is vital in spreading risk in the most appropriate way around a corporate group, clear drafting should be considered in the event that the parties wish to keep the contract truly between themselves. A failure to do so will require the court to pay more regard to the circumstances surrounding the making of the contract.

In this case, the Contract was viewed to be with the charterer (AMS) and not the Rig owner. A key reason was because it seems that the works were required to enable the charterer (AMS) to fulfill a third party contract. This would have been for the direct benefit of AMS, which meant there were good arguments that the Rig owner, AT1, was not principal.

Finally, during the course of argument the Rig owner sought to rely on the agency law 'tome' *Bowstead & Reynolds on Agency* that the doctrine of the undisclosed principal applies only in two types of case, namely where the principal wishes to be a party to a contract, but does not wish it to be known that he has entered the market, or where the agent has authority but does not disclose the existence of the principal, and the principal either acquiesces on this or makes no inquiry as to the agent's notice. However, the judge did not think that the doctrine could necessarily be limited in this regard if the conditions (i) to (iii) of the doctrine referred to above are satisfied.

Judge: MacDonald Eggers QC

Arbitration

Arbitration remains the most popular method of dealing with disputes in the international oil and gas sector. The past twelve months have resulted in some cases of significance to oil and gas arbitration users:

— In *Taurus Petroleum Ltd v State Oil Marketing Co of the Ministry of Oil, Republic of Iraq* [2017] UKSC 64, the Supreme Court has made a major contribution towards assisting the enforcement of arbitral awards in the oil and gas sector and clarified the interpretation of the terms of the letters of credit prescribed by the Iraqi State Oil Marketing Company's standard form of sale contract.

— In *Hardy Exploration & Production (India) Inc v Government of India & another* [2018] EWHC 1916 (Comm), the Commercial Court held that it did not have jurisdiction to make a third-party debt order where the debt in question was situated in a country whose courts would not recognise compliance with the order as discharging the third party's liability to an award debtor. In reaching this conclusion, the Commercial Court set out a number of principles for determining the jurisdiction in which a debt was deemed to be situated for legal purposes. The case provides helpful guidance for parties in the oil and gas industry when considering what assets may be available against which to enforce any judgement or award.

- The Brazilian Superior Court of Justice decided, in a jurisdictional case brought by Petrobras against the Brazilian oil and gas regulatory agency, the National Agency of Petroleum, Natural Gas and Biofuels, that an arbitral tribunal should decide upon its own competence, including on the validity and application of the arbitration clause included in the concession agreement between the ANP and Petrobras.
- In *Halliburton Company v Chubb Bermuda Insurance Ltd & Others* [2018] EWCA Civ 817, the Court of Appeal considered the extent to which an arbitrator may, without the parties' knowledge, accept appointments in several matters in relation to the same or overlapping subject matters with only one common party without giving rise to an appearance of bias. As disputes in the oil and gas industry can reverberate through the value chain, and associated insurance, this decision is of particular interest to the sector.
- In *Progas Energy Ltd and others v Islamic Republic of Pakistan* [2018] EWHC 209 (Comm), the Commercial Court decided that an offer by a litigation funder to meet any adverse costs order did not automatically negate the need for an order for security for costs concerning a challenge to an energy industry arbitration award. The Commercial Court ordered that the party challenging the award should pay security for costs.
- In *Atlas Power Ltd v National Transmission and Despatch Company Limited* [2018] EWHC 1052, the Commercial Court granted an anti-suit injunction to a group of independent power purchasers in Pakistan to prevent a collateral attack against an arbitral award in their favour through the Pakistani courts by the national transmission and dispatch company. The decision highlights the critical importance of carefully drafting arbitration clauses in commercial energy industry contracts.

Enforcing oil and gas arbitral awards against 'award proof' parties

In *Taurus Petroleum Ltd v State Oil Marketing Co of the Ministry of Oil, Republic of Iraq* [2017] UKSC 64, the Supreme Court made a major contribution towards assisting the enforcement of arbitral awards in the oil and gas sector, and other sectors, against certain entities that might otherwise be out of reach from enforcement. In doing so, the Supreme Court has arguably rewritten a rule concerning the law of the place of a debt, which had stood unchallenged for over 35 years. It also clarified the interpretation of the terms of the letters of credit prescribed by the State Oil Marketing Company's ('**SOMO**') standard form of sale contract.

Facts

The appeal to the Supreme Court arose out of an attempt by the appellant, Taurus Petroleum Ltd ('**Taurus**'), to enforce an arbitration award against SOMO.

Taurus' underlying claims arose from a series of contracts between Taurus and SOMO for the sale of crude oil and liquefied petroleum gas ('**LPG**'). Following disputes between Taurus and SOMO, an arbitral tribunal rendered an award in favour of Taurus for approximately USD 8.7m in February 2013. SOMO declined to honour the award.

However, Taurus learned that a subsidiary of Shell purchased crude oil from SOMO; the price for which was to be paid under letters of credit ('**LCs**') issued by the London branch of Crédit Agricole. Taurus sought (without notice) to enforce the award as a judgment pursuant to section 66(1) of the Arbitration Act 1996 by way of third party debt orders under the relevant provisions of the English Civil Procedure Rules (namely, CPR 72). In other words, to have Crédit Agricole pay sums owed by it to SOMO to Taurus, in satisfaction of sums owed by SOMO to Taurus. Alternatively, Taurus sought receivership orders on amounts owed to SOMO under the LCs. The Commercial Court made orders on these terms and funds were paid into the Commercial Court.

Litigation ensued and while SOMO did not contest the application under section 66(1) of the Arbitration Act 1996, it challenged both the third party debt orders and the receivership orders *"principally on the grounds of want of jurisdiction and state immunity but also on the true construction of the letters of credit"*.

SOMO's arguments centred on the fact that each of the LCs provided for payment to be made in New York to the Iraq Oil Proceeds Account at the Federal Reserve Bank of New York. Each LC also contained a separate promise on the part of Crédit Agricole in favour of the Central Bank of Iraq ('**CBI**') to make payment in that way. SOMO contended that the debts created by the LCs were, therefore, situated in New York and that the Commercial Court had no jurisdiction to make a third party debt order. SOMO also argued that the debts were the property of the Republic of Iraq (through CBI) and were, therefore, immune from execution.

Commercial Court Decision

The Commercial Court decided that the third party debt orders and/or execution orders could not be upheld as the debt was owed jointly to SOMO and CBI and, therefore, was outside the scope of CPR 72. Similarly, a receivership order would entail Crédit Agricole having to pay twice (once to Taurus and once to CBI) and, therefore, could not be upheld. However, the Commercial Court did consider that the debt was situated in England and that sovereign immunity did not attach to SOMO. Taurus appealed.

Court of Appeal Decision

The Court of Appeal reached the same conclusion as the Commercial Court but on different bases. The primary reason for the Court of Appeal's decision was that the Commercial Court was wrong in deciding that English law was the *lex situs* (i.e. the law of the place of the debt). Instead, the Court of Appeal was bound by its previous decision in *Power Curber International Ltd v National Bank of Kuwait SAK* [2017] EWCA Civ 27 ('**Power Curber**') that the law of the place of the debt under letters of credit follows the place where payment is to be made against documents. Accordingly, the Court of Appeal held that the *lex situs* of the debt under the LCs was New York and the English courts had no jurisdiction to make the third party debt orders. Taurus appealed to the Supreme Court.

Supreme Court Decision

The law governing debts under the LCs

The Supreme Court unanimously decided that the *lex situs* of a debt is the place of residence of the debtor. Therefore, since the LCs were issued by Crédit Agricole's London branch, the *situs* was England. The Supreme Court concluded that the decision in *Power Curber* in relation to letters of credit *"was wrong in principle and should not be followed"*. Accordingly, the Supreme Court's decision re-writes a rule of more than 35 years that a debt under a letter of credit is situated in the place where documents are presented for payment.

State immunity

SOMO did not pursue its argument on state immunity in the Supreme Court. Perhaps unsurprisingly since the Commercial Court and the Court of Appeal dismissed this point on the basis that SOMO could not benefit from state immunity unlike CBI.

Who owns the debts?
The issue of 'who owns the debt' split the decision of the Supreme Court by a narrow majority.

The main argument arose as to the interpretation of the terms of the LCs and, in particular, the conditions by which Crédit Agricole was required to pay the amounts under the LCs to CBI's account. While the LCs largely followed a standard format, two additional conditions were incorporated into the LCs on the following terms:

> *"[A] Provided all terms and conditions of this letter of credit are complied with, proceeds of this letter of credit will be irrevocably paid in to your account with Federal Reserve Bank New York, with reference to 'Iraq Oil Proceeds Account'."*

These instructions will be followed irrespective of any conflicting instructions contained in the seller's commercial invoice or any transmitted letter.

> *[B] We hereby engage with the beneficiary and Central Bank of Iraq that documents drawn under and in compliance with the terms of this credit will be duly honoured upon presentation as specified to credit CBI A/c with Federal Reserve Bank New York."*

Critically, the effect of these provisions was, arguably, that the amounts under the LCs were (or became) a debt from Crédit Agricole to CBI, rather than to SOMO. If this was the case, a third party debt order would fail, since a prerequisite to such an order under CPR 72 is that there is a *"debt due or accruing due to the judgment debtor from the third party"*. If the debt was due to anyone other than SOMO, the pre-requisite to a third party debt order would not be satisfied.

Ultimately, the Supreme Court decided that Crédit Agricole owed a debt to SOMO and a collateral obligation to pay the debt to CBI's nominated account. Therefore, the Supreme Court decided that the third party debt order could be enforced and that Taurus' appeal should be allowed. The Supreme Court also decided that the collateral obligation to CBI would be extinguished since the primary debt obligation would be satisfied by way of the third party debt order.

While the interpretation of the LCs went according to their exact terms, an important factor was the incorporation of, and definitions provided by, the Uniform Customs and Practice 600 ('**UCP 600**'). The Supreme Court expressly relied on the definition of *"beneficiary"* in Article 2 of the UCP 600 and the confirmation that the beneficiary is SOMO. Ultimately, this led to a decision that the LCs were issued in favour of SOMO and that the primary debt obligation was to SOMO.

Comment

The *lex situs*, or law of the place where the property is situated, of a debt is important because English courts only have jurisdiction to deal with property (such as a debt) where the *lex situs* of the debt is in England and Wales, or where the law applicable in the location of the debt would recognise a third party debt order as discharging the liability of the third party to the judgment debtor. As such, if a debt is domiciled in England, it has a potentially significant impact for banks that might owe a debt (by letter of credit or the existence of a bank account) to an award debtor. In effect, it allows the party successful in arbitration to seek a third party debt order to pay sums owed by a London bank (or other England and Wales domiciled party) to an award debtor.

In reaching its decision, the Supreme Court simply considered that the decision in *Power Curber* was too unreasoned to bring about certainty and clarified, beyond all doubt, that the *situs* of a debt follows the residence of the debtor.

It is also noteworthy that Lord Neuberger considered that Moore-Bick LJ (in the Court of Appeal judgment) was correct that state immunity would apply to CBI but not to SOMO. It is perhaps for this reason that SOMO decided not to pursue an argument of state immunity. This clarification will be welcomed by those dealing with SOMO.

Finally, the deployment of a third party debt order by Taurus to monetise an arbitral award against an entity domiciled in the Republic of Iraq (not a member to the New York Convention 1958) is yet another example demonstrating the alternative routes to enforcement of awards in London. The Supreme Court confirmed that *"London is one of the two major financial centres of the world and enormous numbers of letters of credit are issued by international banks from their London branches"*. Other arbitral award creditors may consider their options to follow in Taurus' footsteps and seek to enforce their awards against counterparties who could otherwise 'hide' from such enforcement.

Judges: Lord Neuberger PSC, Lord Mance JSC, Lord Clarke JSC, Lord Sumption JSC, Lord Hodge JSC

Commercial Court sets out principles for determining where a debt is situated

In *Hardy Exploration & Production (India) Inc v Government of India & another* [2018] EWHC 1916 (Comm), the Commercial Court decided that it did not have jurisdiction to make a third-party debt order ('**TPDO**') where the debt in question was situated in a country whose courts would not recognise compliance with the order as discharging the third party's liability to an award debtor. Although not an oil and gas case, it is relevant to almost all oil and gas contracts and, in particular, EPC contracts. In reaching this conclusion, the Commercial Court set out a number of principles relevant to oil companies seeking to enforce arbitral awards through a TPDO.

Facts

Hardy Exploration & Production (India) Inc, an oil and gas exploration company, had obtained an UNCITRAL arbitration award against the Indian government. It sought to enforce the award by means of a TPDO against India Infrastructure Finance Company (UK) Limited ('**IIFC**'), a finance company, that owed money to the Indian government under a guarantee fee agreement. IIFC resisted the TPDO on a number of grounds, one of which was that the Commercial Court had no jurisdiction because the *situs* of the debt that it owed the Indian government was in India and, as a matter of Indian law, payment pursuant to an order of the English court would not discharge the third party's debt to the Indian government.

Decision

The Commercial Court refused to grant the TPDO. In doing so it set out the following principles:

- The Commercial Court may make a TPDO only where the third party debtor is present within the jurisdiction and (a) the debt is situated in the jurisdiction, or (b) the debt is situated in another jurisdiction, provided that it appears that by the law applicable in that foreign *situs* the English Order would be recognised as discharging the liability of the third party to the judgment debtor.
- The exercise of the court's jurisdiction in respect of a debt is an exercise of sovereign authority and it is a generally recognised principle of international law that the courts of one state shall not trespass upon the authority of another, by attempting to seize assets situated within the jurisdiction of the foreign state.
- The *situs* of the debt is necessarily linked to the law governing debts as recognised by generally accepted principles of private international law. The application of the law governing the debt determines whether or not the relevant debt has been discharged, whether by a TPDO or otherwise, not only for the purposes of that legal system but also other legal systems, thus ensuring that the relevant debtor (including a third party debtor) will not be compelled to pay the same debt more than once.
- The principle determining the *situs* of the debt or other chose in action is that debts or choses in action are generally to be looked upon as situated in the country where they are properly recoverable or can be enforced. That is, the debt or chose in action is situated in the country where it is properly recoverable and can be discharged only by the law of the place where it is recoverable. If the debt cannot be recovered or enforced within the jurisdiction, it is not situated in that jurisdiction.
- The general rule or presumption is that the debt or chose in action is properly recoverable or enforceable

in the place of residence, or domicile, of the debtor.

— That general rule or presumption is open to displacement if it can be demonstrated that the relevant debt is properly recoverable or enforceable in a jurisdiction other than the debtor's residence or domicile.

— The approach to determining the *situs* of the debt will differ if the relevant debt has not yet been established by a judgment or arbitral award or has been so adjudged. Before judgment or award establishing the right to the debt, the debt may be determined as properly recoverable only by a court of a competent jurisdiction to determine whether the relevant debt is properly recoverable or has been discharged. After the debt has been established by a judgment or award, that judgment or award may be executed or enforced by means of the various mechanisms available within each jurisdiction.

In the present case, the guarantee fee agreement did not include an express choice of law, but did include both an arbitration clause and an exclusive jurisdiction clause in favour of India. There was a dispute as to the effect of these clauses under Indian law. After considering expert evidence, the Commercial Court decided that the exclusive jurisdiction clause was effective, and therefore the *situs* of the debt was in India. Since payment under a TPDO would not discharge the debt under Indian law, the Commercial Court decided that it did not have jurisdiction to make such an order.

Comment

The majority of previous authorities on the *situs* of a debt have not set out the applicable principles with the same degree of detail as in this case. By way of example, in *Société Eram Shipping Co Ltd v Cie Internationale de Navigation* [2004] 1 AC 260, the House of Lords held that for a third party debt order to be made the third party had to be within the jurisdiction as did the *situs* of the debt. In *Taurus Petroleum Ltd v State Oil Marketing Co of the Ministry of Oil, Iraq* [2017] 3 WLR 1170, the Supreme Court applied this rule to debts owed under letters of credit.

In particular, there has been very little previous judicial consideration of the potential difference between where a debt is payable and where its existence falls to be determined. This is an important judgement for players in the oil and gas industry, specifically those who want to monetise an arbitration award against a foreign party with limited assets outside their own jurisdiction. The detailed analysis of the law in relation to TPDOs provides helpful guidance for entities when considering what assets may be available against which to enforce any judgement or award. However, it also emphasises the difficulty in relying on TPDOs to enforce arbitral awards concerning foreign parties.

On the other hand, it will come as a relief to oil and gas companies that might have contracts, such as PSAs with foreign entities, such as governments, that have outstanding arbitral awards against them awaiting enforcement. It is apparent from this case that payment of a TPDO by a third party will rarely distinguish a debt under such PSA and as such the TPDO is unlikely to be granted against an oil company in such circumstances.

Judge: MacDonald Eggers QC

Brazil: Superior Court of Justice analyses the scope of arbitration in oil and gas concessions

In *Conflito de Competência* nr. 139519 – RJ (2015/0076635-2), decided on 11 October 2017, the Brazilian Superior Court of Justice ('**STJ**') decided, in a jurisdictional case brought by Petroleo Brasileiro SA Petrobras ('**Petrobras**') against Agencia Nacional do Petróleo, Gás Natural e Biocombustíveis, the National Agency of Petroleum, Natural Gas and Biofuels ('**ANP**'), that an arbitral tribunal should decide upon its own competence, including on the validity and application of the arbitration clause included in the concession agreement between the ANP and Petrobras.

Facts

The dispute started in 2014, when the ANP required the unification of seven different producing oil fields (Baleia Anã, Baleia Azul, Baleia Franca, Cachalote, Caxaréu, Jubarte and Pirambu), part of the Parque das Baleias area, located in Block BM-C-60 offshore from the state of Espirito Santo. The concession for the exploration and production from Block BM-C-60 was awarded to Petrobras in 1998.

By unifying the different fields into one, ANP increased the amount of the so-called Special Participation due from Petrobras, which is a governmental levy, calculated based on the volume of oil produced from oil and gas fields with higher production volumes. The amount of the Special Participation depends on the net production volume, the location of the fields and duration of production. The higher the volume of oil or gas produced, the higher the percentage of Special Participation that is due from the concessionaire. Thus, before the unification, only some of the fields in the Parque das Baleias area were obliged to pay the Special Participation, based on their individual oil production. After the unification, the combined production from the fields was used to calculate a higher rate of Special Participation for all of the fields. On that basis, Petrobras claimed that, if the fields were to be jointly considered, the government take under the concession agreement would move from 49.8% (for separate fields) to 58.5% (for one field), which would have a multi-billion dollar impact on net revenues.

In 2014, after unsuccessfully requesting that the ANP reverse its decision, Petrobras commenced an arbitration against ANP under the concession agreement to obtain a declaration that the ANP's decision regarding unification of the fields was invalid. Under the Brazilian Petroleum Law, arbitration clauses are mandatorily included in all concession agreements for exploration and production of oil and gas.

Following Petrobras' request to institute the arbitral tribunal, the ANP took certain judicial measures to seek to block the arbitration, arguing the lack of competence of the arbitral tribunal to decide on the merits of the case. According to the ANP, its right to charge Special Participation was not derived directly from the concession agreement, but is a power created by the law in its capacity as regulator, and should not be considered a "disposable right". According to Article 1 of the Brazilian Arbitration Act (Law 9.307/1996), only disputes concerning disposable rights can be submitted to arbitration. The ANP also claimed that, if the case were decided by arbitration, the state of Espirito Santo would not be able to participate, despite its direct interest in the dispute. Part of the proceeds of the Special Participation are received by the state of Espirito Santo because the production takes place offshore of its territory.

Petrobras, in turn, requested interim measures to stop the ANP from demanding payment of the Special Participation at the higher rate while the arbitration was pending.

Petrobras and the ANP obtained contradictory decisions from the lower courts and from the arbitral tribunal with respect to the competence of the arbitral tribunal to decide the dispute. This led Petrobras to request a final decision on the competence issue from the STJ. In 2015, Petrobras obtained a preliminary injunction from the STJ to stay all proceedings involving the dispute until the STJ decided on the conflict of competence.

Decision

The majority decision of the STJ confirmed the competence of the arbitral tribunal to decide on its competence, based on the principle 'competence-competence', which was incorporated into the Brazilian Arbitration Act in 2015. According to the STJ, the Brazilian legal system determines that alternative dispute resolution mechanisms, including arbitration, shall have precedence over the courts' jurisdiction, including when one of the parties to the dispute is a public entity.

The STJ made a distinction between public interest objectives, which may not be submitted to arbitration, and the patrimonial rights of public entities, which are arbitrable. The majority concluded that the discussions arising out of a contract entered into by a public entity relate to disposable rights, which are rights that a party can contract out or waive, and therefore can be decided by arbitration. However, the STJ did not determine whether the specific right in question (i.e. to determine the interpretation of 'oil field' to maximise Special Participation revenues) was disposable or not. They said that this is a question for the arbitral tribunal to determine.

The STJ also found that allowing the arbitration would not prevent the state of Espirito Santo from participating in the dispute to protect its interests. Although it was not a party to the concession contract, based on arbitral convention, the arbitral tribunal could allow the state to participate in the dispute as an interested third party.

Comment

While this dispute has been ongoing, the ANP has tried to narrow the applicability of the arbitration clause in new concessions, by including definitions of what it considers to be disposable rights in concession agreements for the 13th and 14th bidding rounds that took place in 2015 and 2017 respectively.

For example, in the 13th bidding round, in 2015, the ANP expressly provided that the interpretation of legal definitions and legal obligations cannot be submitted to arbitration. However, legal interpretation and obligations derived from the law are not, *per se*, 'undisposable rights', as they do not necessarily involve a public interest. An 'undisposable right' is one that a party cannot contract out or waive, as it contains a public interest that the state is given to protect. If such provision of the concession agreement were to be applied literally, the arbitration clause could arguably be rendered ineffective, which would be inconsistent with the mandatory nature of the arbitration agreement, as determined by the Brazilian Petroleum Law.

Following the decision of the STJ, in October 2017, the ANP carried out a public consultation on the latest version of the standard arbitration clause included in ANP contracts, intended to take into account the best international practices with respect to arbitration proceedings involving public entities.

As a result of the public consultation, in 2018 the ANP changed the arbitration clauses of its agreements in certain respects. However, it continues to define the scope of submission to arbitration based on the concept of disposable rights. The new clause now lists four matters that are considered to be disposable patrimonial rights and subject to arbitration: (a) the applicability and calculation of contractual penalties, and disputes relating to enforcement of guarantees; (b) calculation of compensation due to termination or transfer of the agreement; (c) contractual default by any party; and (d) claims in relation to contractual rights or obligations. It is unclear whether the list is intended to be exhaustive or if other claims not expressly listed should be considered to involve disposable rights and be subject to the arbitration agreement. Interpretation of legal obligations or legal definitions is no longer expressly excluded from arbitration.

The STJ continues to apply the principle of 'competence-competence' to uphold the jurisdiction of the arbitral tribunal to rule on its own competence. The approach adopted in the above decision was upheld by a recent decision of Judge Nancy Andrighi in a conflict of jurisdiction case relating to an arbitration brought by minority shareholders of Petrobras against Petrobras and the Federal Government (as the controlling shareholder of Petrobras) for damages resulting from the negative impact on share value of the Car Wash investigation (in STJ – *Conflito de Competência* nr.151.130 – SP (2017/0043173-8), American International Group Inc. Retirement Plan and others, against Camara de Arbitragem do Comercio – CAM-BOVESPA, 13th Federal Court of the Judiciary Section of the State of Sao Paulo, and Regional Federal Appellate Court of the 3rd Region). In that case, the Federal Government sought a court decision that it was not subject to the arbitration agreement, which gave rise to a jurisdictional challenge in the STJ. In a preliminary decision in May 2018, Judge Nancy Andrighi upheld the competence of the arbitral tribunal to decide on its own jurisdiction, thereby confirming the pro-arbitration stance of the Brazilian superior courts.

Judge: Regina Helena Costa

Deepwater Horizon – Multiple arbitrator appointments on same incident

In *Halliburton Company v Chubb Bermuda Insurance Ltd & Others* [2018] EWCA Civ 817, the Court of Appeal considered the extent to which an arbitrator may, without the parties' knowledge, accept appointments in several matters in relation to the same or overlapping subject matters with only one common party without giving rise to an appearance of bias. The arbitrations related to the Deepwater Horizon incident. As disputes in the oil and gas industry can reverberate through the value chain, and associated insurance, the decision is of particular interest to the sector.

Facts

Halliburton Company ('**Halliburton**') had provided cementing and well-monitoring services to BP on the Deepwater Horizon oil rig in the Gulf of Mexico (the '**Deepwater Rig**') and had purchased insurance from Chubb Bermuda Insurance Ltd ('**Chubb**') in relation to potential liability arising from its presence on the Deepwater Rig. Transocean Holdings LLC ('**Transocean**'), who owned the rig, had also purchased the same liability insurance from Chubb on the same terms as Halliburton, in relation to its provision of crew and drilling teams for the Deepwater Rig.

Following the explosion and fire at the Deepwater Rig in April 2010 which caused an oil spillage that attracted international attention, Halliburton made a claim on its liability insurance against Chubb. Chubb refused to pay Halliburton's claim, contending amongst other things that Halliburton's settlement of the claims was not reasonable, and/or that Chubb had reasonably not consented to the settlement. In January 2015, Halliburton appointed the third respondent as its arbitrator and Chubb appointed the fourth respondent as its arbitrator. Halliburton and Chubb could not agree on a third arbitrator for their dispute so an application was made to the High Court for appointment of an arbitrator selected from candidates put forward by both sides. The High Court selected the second respondent, M, who was Chubb's preferred arbitrator. M had disclosed that he had previously acted as arbitrator in a number of arbitrations in which Chubb was involved, including in two pending references where M was appointed by Chubb.

After the date of his appointment by the High Court, M was appointed in two further arbitrations relating to the Deepwater Horizon. First, in a dispute between Chubb and Transocean and, second, in another claim made by Transocean on the same layer of insurance. M failed to disclose to Halliburton that he had been subsequently appointed arbitrator in those two arbitrations. Halliburton issued a claim seeking that M be removed as arbitrator as Chubb was relying on similar arguments in both arbitrations.

The claim was dismissed at first instance by Mr Justice Popplewell who concluded that there was nothing in the acceptance of the Transocean appointments by M which resulted in the appearance of bias against Halliburton, even if the issues in dispute in both cases were identical or substantially overlapping. There was no duty on M to disclose to Halliburton his appointment on an overlapping matter. In any case, even if disclosure ought to have been made, the failure to do so did not give rise to a real possibility of apparent bias against Halliburton. The matter was appealed by Halliburton to the Court of Appeal.

Court of Appeal Decision

The Court of Appeal provided guidance as to when arbitrators should make disclosure of circumstances which may result in doubts about his impartiality and the consequences of failing to disclose such circumstances.

Apparent bias
The Court of Appeal decided, by reference to *AMEC Capital Projects Ltd v Whitefriars City Estates Ltd* [2005] 1 All E.R. 723, that the mere fact that an arbitrator has previously decided on an issue, and accepted appointments in multiple references concerning the same or overlapping issues, does not give rise to apparent bias. Arbitrators are assumed to be trustworthy and to understand that they should approach each case with an open mind. Therefore 'something more' than appointment in overlapping subject matters is required to establish bias.

Disclosure of circumstances which may result in doubts about the arbitrator's impartiality
There are no statutory requirements in relation to disclosure but under common law, judges should disclose facts or circumstances which could give rise to doubts about their impartiality. The Court of Appeal formulated an objective test that it found applies equally to judges and arbitrators:

> *"disclosure should be given of circumstances which would or might lead the fair-minded and informed observer, having considered the facts, to conclude that there was a real possibility that the tribunal was biased (…) the test is an objective one, to be judged by reference to what the fair-minded and informed observer would or might conclude."*

The decision as to whether or not to disclose a potential bias is to be determined prospectively by reference to an objective test. The Court of Appeal agreed with the LCIA rules that disclosure is only required of facts or circumstances known to the arbitrator but clarified that there is no duty of inquiry.

In terms of the consequences of failing to disclose circumstances which may result in doubts about the arbitrator's impartiality, the Court of Appeal found that if a disclosure that ought to have been made has not been made that will mean the arbitrator has not displayed the 'badge of impartiality' that he should have.

Result
The appeal was dismissed on the basis that there was no apparent bias as the non-disclosure was accidental and the similarity of the overlapping issues did not give rise to any significant concerns. Applying the objective test, a fair and minded observer would not consider that the mere oversight to disclose would give rise to justifiable doubts as to M's impartiality.

The Court of Appeal considered the following factors relevant from the perspective of the fair-minded and informed observer: (1) the non-disclosed circumstance does not in itself justify an inference of apparent bias; (2) disclosure ought to have been made, but the omission was accidental rather than deliberate; (3) the very limited degree of overlap means that this is not a case where overlapping issues should give rise to any significant concerns; (4) the fair-minded and informed observer would not consider that mere oversight in such circumstances would give rise to justifiable doubts as to impartiality; and (5) there was no substance in Halliburton's criticisms of M's conduct after the non-disclosure was challenged or in the other heads of complaint raised by them.

The Court of Appeal found that it was likely that M had done everything he could to ensure that his appointment in other matters did not affect his approach in the present matter. Nevertheless, the Court of Appeal did comment that best practice in international arbitration would require the disclosure to have been made.

Comment

Oil and gas disputes, or related insurance disputes, can turn on issues of a highly technical nature or specific industry standards. As such, arbitrator availability with the required expertise may be limited.

The decision of the Court of Appeal ensures that the available 'pool' of arbitrators is not unnecessarily narrowed, by disqualifying any individual that has previous or current appointments concerning the same or similar issues, facts, or law. An arbitrator may acquire information and knowledge from appointment on overlapping issues, but that does not necessarily cast doubt as to the arbitrator's impartiality. This case clarifies that the arbitrator will only be disqualified if there is 'something more' which is also 'something of substance' that could be perceived as tainting the arbitrator's impartiality. In taking this approach, English law allows arbitrators (as judges) to develop areas of expertise that are useful to commercial parties.

The importance placed by the Court of Appeal on disclosure of circumstances that may give rise to justifiable doubts as to the arbitrator's impartiality is of significance. Provided an arbitrator has done everything she or he could to ensure that nothing influenced in any way his approach to the current dispute they should be entitled to be appointed.

An apparent bias may arise if the arbitrator fails to disclose any matter which a fair and reasonable person would deem should have been disclosed. However, even this will not, in itself, result in immediate disqualification.

Judges: Sir Geoffrey Vos QC, Simon LJ, Hamblen LJ

Security for costs in challenging an energy arbitration award

In *Progas Energy Ltd and others v Islamic Republic of Pakistan* [2018] EWHC 209 (Comm), the Commercial Court decided that an offer by a litigation funder to meet any adverse costs order did not automatically negate the need for an order for security for costs concerning a challenge to an energy industry arbitration award. The Commercial Court ordered that the party challenging the award should pay security for costs.

Facts

The Claimants were all incorporated in Mauritius. The First Claimant ('**Progas Energy**') wholly owned the Third Claimant ('**Sheffield Engineering**') which, in turn, owned 23.75% of the shares in Progas Pakistan Limited ('**PPL**'), an energy company incorporated in Pakistan which built and operated an import terminal for liquefied petroleum gas ('**LPG**') at Port Qasim in Karachi, Pakistan. Progas Energy additionally owned 61.8% of the shares in the Second Claimant ('**Progas Holding**') which, in turn, had a 44.99% shareholding in PPL. Between them, therefore, the Claimants own the majority of the shares in PPL.

Mr Ali Allawi was the chairman of PPL and an investor, through the Claimants, in PPL. A British citizen, he was formerly a minister in the Iraqi transitional government.

PPL imported LPG for sale into Pakistan. Its business, however, suffered, the Claimants say owing to Pakistan's wrongful conduct, and as a result PPL defaulted on repayment of various loans. PPL's lenders having taken various actions to recover what they were owed, PPL's assets were put up for auction by the High Court of Sindh in Karachi, the terminal operated by PPL being sold to SSGC LPG Ltd ('**SSGC**'), a subsidiary of Sui Southern Gas Company Limited (a company majority-owned by the Defendant).

The Claimants brought a claim against the Defendant in an UNCITRAL arbitration pursuant to the Mauritius-Pakistan Bilateral Investment Treaty. The Claimants claimed, *inter alia*, that their business had suffered owing to the Defendant's wrongful conduct, which had caused the Claimants to default on various loans. The arbitral tribunal comprised Yves Fortier QC, Judge Charles Brower and Christopher Thomas QC. The Tribunal issued its award on 30 August 2016, dismissing the Claimants' claims and awarding significant costs in Pakistan's favour.

The Claimants applied under UNCITRAL Rule 39 seeking an additional award on the basis that the arbitral tribunal had failed to consider certain aspects of their claim, which application was dismissed.

Pakistan then made a demand for payment of its costs from the Claimants pursuant to the award. The Claimants did not respond to that demand, nor make payment.

A month later, the Claimants commenced proceedings under section 68(2)(d) of the Arbitration Act 1996 (the "**Act**") on the basis that there had been a *"failure by the Tribunal to deal with all issues that were put to it"*. In response, Pakistan sought an order for summary dismissal of the Claimants' section 68 proceedings, which application was dismissed on 18 October 2017.

Following the dismissal of that application, Pakistan made an application for security for costs under section 70(6) of the Act and an application under section 70(7) for the award sum to be *"brought into court or otherwise secured"*. In the context of the Claimants being funded by a third party litigation funder, two key questions arose:

- Was Pakistan entitled to security for costs under section 70(6) of the Act?
- Was Pakistan entitled to have the costs awarded to it in the arbitral award for successfully defending the claim paid into court under section 70(7) of the Act?

Decision

In granting the application for security for costs (in part), and dismissing Pakistan's application to have the costs awarded to it in the arbitral award paid into court, the Commercial Court decided:

Funder's offer and the section 70(6) application
The litigation funder's offer to meet Pakistan's costs did not constitute a contractual commitment to meet any costs order in Pakistan's favour. The offer was not legally enforceable, nor was it in the form of an undertaking to the court (and even if it had been, that would not have entitled Pakistan to a costs order because the remedy for breach of an undertaking is committal, not an order for payment). The offer did not mean that the Claimants had assets 'available' to them such that no security would be necessary. The purpose of the security for costs jurisdiction was to enable a defendant to recover costs subsequently awarded to it without delay or other difficulty. It was an inappropriate answer for a claimant facing a security application to point to the defendant's ability to make a different application, for example under the Senior Courts Act 1981 section 51 as the Claimants suggested, against a different party (i.e. the funder). In this case, the Claimants would need to provide security in the sum of GBP 400,000. Pakistan's projected costs of GBP 480,000 were not exorbitant, but the Commercial Court trimmed the level of security to reflect the likelihood that not all costs would be recovered on assessment. The application was granted.

The section 70(7) application
An application by Pakistan was also made under section 70(7) of the Act, which states:

> *"The court may order that any money payable under the award shall be brought into court or otherwise secured pending the determination of the application… and may direct that the application… be dismissed if the order is not complied with."*

In respect of an application under section 70(7) of the Act concerning a section 67 challenge there are two requirements that generally need to be met for the exercise of the power under section 70(7), namely whether: (i) the challenge *"is flimsy or otherwise lacks substance"*; and (ii) the challenge in some way prejudices the ability of the Defendant to enforce the award or diminishes. However, the position in relation to section 68 of the Act, as here, is different in that there is no need to establish the first of these requirements.

Pakistan sought to have costs awarded in its favour paid into court pursuant to section 70(7) of the Act. The Commercial Court acknowledged that this case appears to be the first occasion when an application under section 70(7) has been made where: (i) the application is brought against a party funded by a professional third party funder who has not paid an adverse costs order by an arbitral tribunal, and is seeking (through the party which it is funding) to re-run the arbitration which that party has lost, in circumstances where there was no ability on the other party's behalf to seek an order against the funder in the underlying arbitration; (ii) where the claimant, funded by the same professional funder, comes before the court only by way of a challenge under section 68, and not also under section 67, so that the first limb of the test applicable to section 67 applications (namely that the challenge *"is flimsy or otherwise lacks substance"*) is inapplicable; and (iii) where the sum in respect of which security is sought is for adverse costs alone, rather than consisting of (or including) a damages award.

The Commercial Court decided:

- The authorities dealing with section 70(7) identified an approach which should apply whether or not the case involved commercial funding.
- The Commercial Court reiterated that in order to show that the ability to enforce an award has been prejudiced or the ability of the applicant to honour it has been diminished, it is *"effectively necessary to satisfy a similar requirement to that of a freezing injunction, namely the risk of dissipation of assets"* between the time of the section 68 application by the Claimant, as here, and its final disposal. The facts of this case did not disclose a serious risk of dissipation of assets.

The power to order security under section 70(7) in the event of an arbitral challenge was necessarily linked to the making of such a challenge. Therefore, there had to be something brought about by the challenge which made a security requirement appropriate. If the arbitral challenge put the respondent in no worse a position, an order under section 70(7) should not be made. A party should not be permitted to use section 70(7) to avoid having to take enforcement steps, which, were it not for the challenge, would have to be taken. It did not matter that the court could require third party funders to pay costs pursuant to section 51 of the Senior Courts Act 1981: that jurisdiction was expressly concerned with non-party costs orders, whereas section 70(7) was not. Nor did it matter that security was sought in respect of the costs of the underlying proceedings. The claimants were entitled to bring the section 68 challenge; it would be wrong in principle to introduce into the Act a precondition through the operation of section 70(7), which was not in the Act itself. The application was dismissed.

Comment

As international arbitration remains an important facet of settling international energy disputes, the efficient and fair enforcement of arbitral awards is critical to the energy industry. The decision of the Commercial Court reinforces that:

- Security for costs is available against a party challenging an arbitral award in the English courts.
- The existence of a litigation funder that has 'deeper pockets' than the party challenging the award, and may be able to meet any adverse costs award, is not necessarily an answer to a security for costs application. It seems that in most circumstances the existence of a litigation funder will not be relevant.
- However, in relation to the substance of the dispute, the English courts will not require payment into court of sums in dispute as a pre-condition to challenging such awards, unless there is a risk of dissipation of assets.

As such, parties challenging an award in England should keep in mind that they may be asked for evidence concerning their financial covenant to satisfy an adverse costs award should they fail in their challenge. Absent evidence of such covenant, the English courts may award security for costs as a condition of making a challenge.

Judge: Picken J

International PPAs: High Court protects arbitration process

In *Atlas Power Ltd v National Transmission and Despatch Company Limited* [2018] EWHC 1052, the Commercial Court granted an anti-suit injunction to a group of independent power purchasers in Pakistan ('**IPPs**') to prevent a collateral attack against an arbitral award in their favour through the Pakistani courts by the national transmission and dispatch company. The IPPs had successfully brought an LCIA arbitration, seated in London, against the national transmission and dispatch company, under their power purchase agreements ('**PPAs**'). The Commercial Court decided that any challenge to such arbitration award must be made through the courts of England and Wales, not in Pakistan. Although this is a power industry case, it is equally applicable to the oil and gas industry.

Facts

The claimants were the nine IPPs registered in Pakistan generating and supplying energy solely to National Transmission and Despatch Company Limited ('**NTDC**') pursuant to the PPAs. NTDC is owned by the Government of Pakistan. It is a National Grid Company licensed by the National Electrical Power Regulatory Authority of Pakistan.

Each of the nine PPAs is expressly governed by the law of Pakistan and contained a provision for arbitration. The central issue between the parties was whether the courts of Pakistan have supervisory jurisdiction over the arbitration.

PPA arbitration clause

The arbitration clause provided that any dispute was to be settled by arbitration in accordance with the LCIA and conducted in Lahore, Pakistan. It further provided that if the value of the dispute was above a certain threshold or fell within a certain category, either party could require that the arbitration be conducted in London.

Dispute

The underlying dispute arose as to sums allegedly owed by NTDC to the IPPs. The IPPs initiated an expert determination process which concluded with a finding that NTDC was liable to pay specified amounts to each of the IPPs on the basis that those amounts had been unlawfully withheld (the '**Determination**'). NTDC challenged the Determination following which the IPPs commenced LCIA arbitration proceedings. The IPPs exercised their rights to designate London as the seat of the arbitration on the ground that the value threshold in the arbitration clause had been exceeded. The LCIA issued the partial final award finding, amongst other things, that the Determination was final and binding and that the seat of the arbitration was London.

NTDC commenced proceedings challenging the partial final award both in the Commercial Court in London (which were subsequently discontinued) and in the Court of the Senior Civil Judge in Lahore. The IPPs issued an arbitration claim seeking a final anti-suit injunction to restrain NTDC from challenging the partial final award by way of proceedings in Lahore, Pakistan or in any jurisdiction other than England and Wales.

Arguments of the parties

The IPPs argued: (1) the seat of the arbitration was London (2); it would have been open to NTDC to mount a challenge to the determination of the seat by the arbitrators and LCIA Court under section 67 (and possibly sections 68 or 69) of the Act, but no such application was made; (3) accordingly, there was no basis on which NTDC could dispute that the seat of the arbitration was London; and (4) as the seat of the arbitration was London, supervisory jurisdiction over the arbitration was exclusively a matter for the courts of England and Wales, such that an anti-suit injunction should be permitted to prevent proceedings elsewhere.

NTDC made clear that its primary case was not a challenge to London as the seat of the arbitration but whether the parties had validly and lawfully chosen London as the seat of the arbitration. NTDC argued that:

- The choice of a London seat gave rise to concurrent jurisdiction of the Pakistan courts because the governing law of the PPAs was the law of Pakistan, and therefore the provisions as to the choice of seat of the arbitration had to be construed as a matter of the law of Pakistan which does not provide for exclusive supervisory jurisdiction of England and Wales; and
- if the choice of a London seat could not be construed as giving rise to concurrent jurisdiction of the Pakistan courts, that choice would be invalid as being contrary to the relevant policy of the governing law of the PPAs. The seat had to be therefore Lahore, Pakistan.

Decision

NTDC's argument that the courts of Pakistan had at least concurrent supervisory jurisdiction, even if the seat of the arbitration was London, was rejected, as was its alternative argument that the seat was Lahore.

The Commercial Court referred to the Court of Appeal decision in *C v D* [2008] 1 Lloyd's Rep. 239, where the Court of Appeal made it clear that where the seat of the arbitration was England, proceedings on the award should be only those permitted by English law. In that case, Longmore LJ concluded that the parties *"must be taken to have so agreed"*, *"a choice of seat for the arbitration must be a choice of forum for remedies seeking to attack the award"* and *"their agreement on the seat and the "curial law" necessarily meant that any challenges to any award had to be only those permitted by that [the Act]"*.

Applying *C v D*, in considering the issue of supervisory jurisdiction over the arbitration, the Commercial Court noted that it is the seat of arbitration that determines the *"curial law"* (the law governing the arbitration proceedings) of the arbitration, not the governing law of the contract. The Commercial Court found that:

- NTDC had to be treated as bound by the decision of the LCIA Court as to the seat of the arbitration, and by the further rulings of the Arbitrator in that regard; and
- the IPPs were entitled to a final anti-suit injunction to restrain NTDC from challenging an LCIA partial arbitration award in Lahore, Pakistan, or anywhere other than England or Wales on the basis that the seat was London.

Comment

The decision highlights the critical importance of carefully drafting arbitration clauses in commercial energy contracts. Although getting the arbitration clause right will not guarantee a successful arbitration, it will increase the chances of successfully securing a neutral venue and process for disputes to be heard, minimise the prospects from interference from local courts and make enforcing an award significantly less risky.

Parties negotiating an arbitration clause should have in mind that the choice of seat for an arbitration carries with it important consequences in terms of the legal regime to which the arbitration process will be subject to in relation to the challenges to awards. If NTDC were to challenge an LCIA partial arbitration award, they would have to do it in the English courts where its options for challenge are limited.

Judge: Phillips J

UK Oil and Gas Industry Regulation 2018

OGA puts its building blocks in place

Having dealt with the 'easy wins' during its first full year of operations, OGA's attention in its second year turned to two main tasks: putting some detail around the outline structure that it built during its first year and helping industry understand what 'business as usual' might now look like for OGA and the industry as a whole.

Gathering, retaining and sharing information and data has been a significant area of focus – from the introduction of requirements regarding information and sample plans and information and sample co-ordinators to plans for the first UKCS National Data repository. Collaboration is another key theme which is beginning to take shape, for example through the further work on Area Plans. OGA has also started to grapple with what regulatory decision making and enforcement might look like, including for example: issuing guidance on its approach to exercising various of its decision making powers; consulting on how to approach assessing whether an investment will produce a *"satisfactory economic commercial return"* ('**SECR**'); and indicating that the first processes under its Sanctions Procedure are under way.

Further details of some key developments since our 2017 Annual Review of developments in English oil and gas law are set out below:

Information

Information and samples

Timely and transparent access to petroleum-related information and samples was one of the recommendations in the 2014 Wood Review in order to achieve MER UK. OGA considers that improving the process in relation to the retention and disclosure of information could unlock a potential GBP 140bn additional revenue from increased oil and gas activity and collaboration.

OGA has addressed two specific areas in this regard: the preservation of information and samples, both existing and as gathered or created by the industry; and the publication, sharing and disclosure of information or samples once gathered, to try to provide a basis for more efficient and cost-effective use of the industry's collective knowledge.

The Energy Act 2016 (the '**Energy Act**') has been brought into effect in phases. As regards OGA's powers, the provisions regarding information and samples plans and co-ordinators (sections 30 to 36 of the Energy Act) came into force on 21 October 2017. In advance of that, OGA consulted industry regarding: (i) what information and samples industry should be required to retain, how and for how long; and (ii) time periods for subsequent disclosure by OGA of information and samples it holds or acquires. Various practical details have or are now being addressed by way of regulations and guidance from OGA to assist the industry with understanding precisely what is now required of it as a result.

Preservation of Information and Samples – Information and Sample Plans (ISP)

Sections 30 to 33 of the Energy Act require a responsible person (i.e. licensee) to: prepare an ISP in connection with a licence event (broadly, a transfer of any licence interests); agree the ISP with OGA; and comply with it. OGA's Guidance on Information and Sample Plans was published on 2 October 2017, in advance of sections 30 to 33 being brought into effect, to provide more detail on OGA's expectations as to how these should be implemented.

Preservation of Information and Samples – Information and Sample Co-ordinators (ISC)

Section 35 of the Energy Act requires a relevant person to appoint an ISC and to notify OGA of that person's name and contact details. The ISC is responsible for monitoring the relevant person's compliance with its obligations under the Energy Act and working within their organisation to ensure information and samples are reported and retained. He or she also acts as primary point of contact with OGA for communications relating to petroleum-related information or samples – taking responsibility for routine reporting, ad hoc queries and regarding development of ISPs as well as ensuring that the Energy Act is complied with in responding to OGA notices for information requested under the Energy Act.

The extent of the ISC's role depends greatly upon the extent and nature of the licence interests held by their employer but it is thought it could amount to a full time role in some organisations. OGA published Guidance on the Role of Information and Samples Coordinators on 2 October 2017 in advance of section 35 coming into effect.

Preservation of Information and Samples – Retention Regulations

The Oil and Gas Authority (Offshore Petroleum) (Retention of Information and Samples) Regulations 2018 (SI 2018/514) (the '**Retention Regulations**') came into force on 14 May 2018, creating obligations to retain certain types of petroleum-related information and samples held on or acquired or created after that date. The focus is on preserving detailed technical information – Part 2 of the Retention Regulations specifies the particular petroleum-related information that must be retained; Part 3 of the Retention Regulations sets out the equivalent obligations with regard to petroleum-related samples.

The precise obligations placed on a particular company depend on the capacity in which a company holds or creates the information, and the nature or type of the information or samples in question. In most cases the obligation to retain the information and samples lasts indefinitely unless and until provided to OGA in response to an OGA requirement under section 34 of the Energy Act.

OGA's stated intention, through the Retention Regulations, is to make the retention process simpler and cheaper for industry bodies, and to help keep the cost burden involved at a minimum. Guidance has also been produced by OGA, 'Retention of Information and Samples Guidance', with a view to assisting industry in understanding the Retention Regulations and fulfilling the requirements involved.

Provision of information & samples to OGA

OGA has various powers under the Energy Act to require relevant persons to provide it with a broad range of information. That includes reporting requirements in relation to information and samples in section 34 of the Energy Act. Neither the Retention Regulations nor OGA's Guidance address those reporting requirements. Further information on that, and associated regulations, are expected at a later date.

Disclosure of information & samples

The Energy Act contains a general prohibition on disclosure by OGA of information it acquires in the exercise of its powers. That is subject to a number of exceptions, for example to permit sharing of certain information with other government departments and executive agencies in the course of their work. Another exception (section 66 of the Energy Act) permits information and samples obtained by OGA under Chapter 3 Part 2 of the Energy Act to be disclosed after a specified period. The draft Oil and Gas Authority (Offshore Petroleum) (Disclosure of Protected Material after Specified Period) Regulations 2018 (the '**Disclosure Regulations**') are intended to implement that exception by specifying the time at or after which OGA can publish certain protected material or make it publicly available. The Disclosure Regulations were laid in draft before Parliament on 13 June 2018. These are subject to the affirmative parliamentary procedure – assuming they pass through that process and subject to the parliamentary timetable, it is expected they will be laid and made by the Department for Business, Energy and Industrial Strategy sometime in the Autumn.

UK's first oil and gas National Data Repository

A key recommendation from the 2014 Wood Review identified *"ready access to timely data is a prerequisite for a competitive market and … even more important in an industry which relies on good data to create value"*. With a view to achieving that and following a consultation in late 2017, which was received positively by industry, OGA intends that the UK's first oil and gas National Data Repository (NDR) will be established in early 2019. It will be funded and maintained by means of an increase in OGA's levy. As an interim measure OGA intends an initial two year contract with Common Data Access to allow all licensees to have access to CDA's data repository. That will be replaced in due course by a new NDR service provider, to be identified by way of a tender process intended by OGA to be carried out during that two year period, with a view to the service commencing in January 2021.

Statutory Meetings

OGA's Statutory Notice on Meetings was updated with effect from 3 October 2017. OGA has very broad powers under Part 2, Chapter 4 of the Energy Act 2016 to be notified of, attend and participate in almost any meeting between regulated oil and gas companies. To focus its efforts and resources appropriately, OGA issued a Statutory Notice soon after those powers came into effect to identify the key meetings that would be required to be notified to it. The updated Statutory Notice amends this list of industry meetings which fall within the advance notification requirements of the Energy Act 2016. The list demonstrates OGA's current areas of focus.

Collaboration

Supply Chain Action Plans

Issued in December 2017, OGA's Guidance on Supply Chain Action Plans describes a new approach aimed at improved efficiency and cost effectiveness of projects undertaken in the UKCS. For all projects requiring a Field Development Plan or a Decommissioning Plan, operators are required to set out a Supply Chain Action Plan to assist in facilitating and demonstrating that it is achieving maximum value from that activity. It covers areas such as contracting policy, project overview and evidence of engagement, trust, innovation and quality. Tier 1 contractors that are engaged to deliver a project are to be encouraged to similarly produce an Action Plan regarding their engagement with their supply chain.

Area Plans

A main plank of the MER UK Strategy is to focus not on individual fields but on maximising the production of the basin as a whole, and key to this is the use of 'Area Plans'. An Area Plan is *"a proposal for action developed in partnership between OGA and industry as to how economic recovery should be maximised in a particular geographical area"*. OGA's 'Guidance on the Development and Use of Area Plans' is intended to bring some clarity to the question of how 'plans' and 'strategies' might be deployed. The Guidance describes a tripartite split for Area Plans:

— *An Initiate Phase:* covering preparation of a scope of work document and a project execution plan. For 'key' Area Plans, OGA will take the lead in the SOW.

— *A Work Phase:* an 'Industry Project Lead' is expected to take responsibility for assessing, selecting, and defining scenarios for the Area Plan.

— *An Execute Phase:* Industry is again expected to take the lead. If adequate and timely steps are taken to fulfil the Plan, OGA states it will support industry activities through its regulatory role, but may use its powers to steward the Area Plan if industry does not execute the specific actions per the agreed schedule. Clearly, that could include imposing sanctions if OGA considers it appropriate.

All parties will be required to cover their own costs of involvement in all phases of an Area Plan. That is notwithstanding that the Plans are *"not intended to guarantee commercial returns for participants"*, but are instead intended to demonstrate achievement of the principal objective and the meeting of MER UK obligations, required actions, and behaviours.

The Infrastructure Code of Practice (ICOP)

ICOP was updated in August 2017 – this sets out good practice principles to guide negotiations for third-party access to oil and gas infrastructure in the UKCS. Although it is a non-statutory voluntary Code (developed by Oil & Gas UK) OGA has made clear that it expects parties to comply with ICOP in relevant negotiations. The Code and accompanying guidance have been updated, for example, to reflect the new world of MER and the 'principal objective'. OGA is the ultimate arbiter in the event that such negotiations are unsuccessful, stepping into DECC's historic role to determine terms for access to third party infrastructure.

OGA decision making

Guidance on OGA's onshore decision making framework
This Guidance relates specifically to OGA's powers in relation to onshore licensing powers in England (and Wales, until that power is devolved to the Welsh Assembly; it has already been devolved in Scotland), and setting out in more detail the factors that OGA will consider in its decision making regarding onshore licences.

Guidance on field development approvals
Revising earlier guidance on planning and gaining consent to UKCS field developments, the Guidance emphasises early project planning and supply chain collaboration, including the use of Supply Chain Action Plans. It covers areas such as: OGA's objectives and considerations relevant to all new field developments; the Assessment Phase leading to Concept Selection; the Authorisation Phase leading to consent to a Field Development Plan (FDP); the Execute Phase up to production; and the FDP Addendum, revising a previously consented-to FDP.

Guidance on management of offshore licence work programme commitments
Paragraph 12 of the MER Strategy provides that, if a party does not intend to carry out a firm work commitment (i.e. the minimum amount of work that an applicant must complete in terms of its licence) because it will not make a satisfactory expected commercial return then it must carry out: (i) a work programme of the same or a similar nature to that referred to in the licence; or (ii) another work programme as the licence may agree with OGA enables the Central Obligation to be met. This Guidance sets out how OGA assesses whether or not a proposed alternative work programme meets either of these two criteria. The approach described is intentionally more flexible than has been available in the past – based amongst other things on the assumption that a firm work commitment should be able to be considered as investment into the UKCS that can be 'banked', so that any proposed alternatives are expected to be of a similar cost to the original work programme (albeit other factors are also relevant to the overall decision).

Revised 'Guidance on the assessment of licensee financial capability'

In June 2018, OGA sought industry's views on proposed revised Guidance on how OGA assesses a licensee's financial capability at the time of a licensing event such as licence awards. The proposed new Financial Guidance sought to take a less rigid approach in considering licensees' financial capability in light of the different funding models now being used in the industry and set out the key factors OGA intended to take into account, covering the two broad criteria of financial viability and financial capacity. Guidance has now been issued which largely follows the approach taken in the Consultation.

The assessment on financial viability is based on a company's historic and current solvency, and assesses whether the company is expected to remain solvent in the future. Financial capacity assessment considers the applicant's future commitments, both known and anticipated, along with OGA's assessment of the applicant's net worth, to determine whether the applicant has the financial capacity to meet the commitment it is making to OGA.

The output will be a risk-based assessment, setting out OGA's assessment of the applicant's financial capability along with a recommendation to the OGA decision-maker as to how to proceed. This recommendation will not be conclusive, as OGA must also consider various other factors, such as the technical capabilities of the applicant, the requirements of MER UK and the matters set out in the Energy Act 2016 to which it must have regard. Ultimately, each application will therefore be assessed on a case-by-case basis.

Guidance on "*satisfactory expected commercial return*"

In December 2017, OGA published a consultation on how it intended assessing whether a particular investment would provide a *"satisfactory expected commercial return"*. That term is key to the safeguard set out at paragraph 3 of the MER Strategy, that *"No obligation imposed by or under this Strategy requires any person to make an investment or fund activity (including existing activities) where they will not make a satisfactory "expected commercial return" on that investment or activity"*. The MER Strategy includes a definition of "*satisfactory expected commercial return*" – an *"expected commercial return": an "expected post-tax" that is reasonable having regard to all the circumstances including the risk and nature of the investment (or other funding as the case may be) and the particular circumstances affecting the relevant person"* – but since that is a basis upon which a relevant person may legitimately refuse to carry out an otherwise necessary investment (potentially at significant value) or may impact whether or not a relevant person must divest or relinquish an asset (in terms of paragraphs 30 to 34 of the MER Strategy) the precise assessment could be very significant in certain cases.

OGA published a response to the consultation in late August and simultaneously delivered its new formalised Guidance on SECR. With a view to transparency, the Guidance seeks to describe an approach that allows an 'objective' assessment of whether or not a particular investment would meet the SECR test. However, this is not to be a 'one size fits all' test. OGA acknowledges that companies use a wide range of metrics and inputs in assessing their returns, not all of which are included in the Guidance. The topic of SECR was always likely to be a particularly thorny one for OGA and it has sought to assure industry that, where the SECR safeguard is applied, it will take a pragmatic approach, including having discussions with the companies involved, to understand the project.

Sanctions

OGA takes a holistic view of its various powers and regards its sanction powers as only one of a number of options open to it, which also include its non-binding dispute resolution powers, its (separate) decision making powers regarding access to infrastructure and its influencing powers (including its right to attend and participate in meetings). It has however indicated that it does not regard sanctions as a 'last resort' but will implement that process (described in its Sanction Procedure) where it considers it appropriate to do so. It has not yet published details of any sanctions on its website – since it has indicated an intention to do so, that appears to indicate that no such sanctions have yet been imposed. It has, however, indicated that during 2018 it has launched its first formal Investigations under its Sanction Procedure. OGA's approach on Sanctions may therefore become clearer over the course of the next year.

Any such steps are likely to be closely followed by industry, and it will be interesting to see over the next year the extent to which OGA makes public any detailed information regarding is activities in connection with the exercise of its formal powers and, if it does, the circumstances in which OGA considers it appropriate to launch sanctions enquiries or investigations and where it prefers to turn to its influencing powers or non-binding dispute resolutions powers.

Model clauses

The model clauses for UKCS licences were amended by regulations in September 2017 with very little fanfare – the Petroleum and Offshore Gas Storage and Unloading Licensing (Amendment) Regulations 2017 amended the Petroleum Licensing (Production) (Seaward Areas) Regulations 2008 to introduce the flexibility needed for the 'Innovate' licence, as set out in OGA's consultation and response from earlier in 2017.

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