

JOAs: you win some, you lose some

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The body of case law dealing with Joint Operating Agreements (JOAs) is comparatively limited. In the last two years, there have been two JOA cases of particular interest which have, unusually, reached the Court of Appeal. In the recent [Spirit Energy Resources Ltd & Ors v Marathon Oil UK LLC \[2019\] EWCA Civ 11](#), the Court of Appeal engaged in detailed construction of a JOA and found for the Operator. In the earlier case of *Pan Petroleum Aje Ltd v Yinka Folawiyo Petroleum Co Ltd & Ors* [2017] EWCA Civ 1525, the Court of Appeal also had to consider the rights of parties under a JOA, and ultimately favoured the non-Operator. They demonstrate that every case is only as good as its facts.

In *Spirit Energy*, the dispute turned on whether non-operating Participants bore the liability for pension deficit recovery charges in respect of a defined pension scheme for the employees employed by the Operator (Marathon) in relation to the Brae Fields operation in the North Sea. It was common ground that Staff were properly employed by the Operator in relation to the operations. The Participants also accepted that employee remuneration included pension benefits and that the Operator was permitted to fix the remuneration of its employees. The issue was whether Participants had any liability

whatsoever, pursuant to the JOA, in respect of the pension deficit charges.

It is unknown whether the JOA followed any particular standard form. Clauses were cited in the case reports of both first instance and Court of Appeal, but there is no indication as to whether the entire contract was on a standard form or standard form with amendments.

At first instance, Knowles J construed the JOA and found decisively in favour of the Operators. The Participants appealed to the Court of Appeal on the grounds that they

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could not be liable for the pension deficit charges unless the OpCom had approved these charges as part of a work programme and budget, and OpCom could not be compelled to give that approval.

The Court of Appeal dismissed the Participants' appeal. Green LJ, giving the lead judgment of a unanimous Court, engaged in a close textual reading of the JOA. He applied the principles from *Arnold v Britten* [2015] UKSC 36, looking first to the natural and ordinary meaning of the words by reference to:

- The individual clauses of the JOA
- JOA as a whole
- A purposive construction of JOA against relevant legal principles incorporated into the Agreement by the parties.

As the parties had themselves incorporated guiding legal principles into the JOA, there was no need to refer to broader concepts of commercial common sense.

The JOA had as an express purpose that the Operator should be "*held neutral*" and should suffer neither a benefit nor a loss. Further, the

JOA adopted mandatory ("shall") and broad language ("all costs") as regards the costs that were to be borne by the Participants.

The express provision for "*Hold Neutral*" proved the guide to construction of the JOA. Together with the language of the JOA, this led to the conclusion that the Participants thus could not take the benefit of the employees' work without the consequent burden in the form of employee pensions:

"There is no identifiable logic whereby the Participants can take the benefits but avoid the risks."

The Participants majored on an argument that the Court's interpretation would grant the Operator "a blank cheque". Green LJ considered this concern more illusory than real. The Operator had already accepted (as was strategically sensible) that it was under a duty to act genuinely, honestly and in good faith. Any contractual discretion that the Operator had would have to be exercised in accordance with that duty. The requirement for good faith would be combined with the OpCom approvals system. OpCom, by approving plans and budgets, in effect pre-authorised cheques for certain line items,

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even if the total to be written on the cheque was unknown at the time of pre- authorisation. Operators would then be liable for any “cheques written” dishonestly or in bad faith. The combination of the pre- approval system and the duty admitted by the Operator was sufficient to provide protection for the Participants. The facts of this case were such that the Court found the Participants to be sufficiently protected. However, given the vagaries of case law surrounding good faith duties in the common law, Participants should be apprehensive about the degree of protection provided by this duty in other less clear-cut factual scenarios.

Pan Petroleum illustrates a scenario arising in which parties to a JOA effectively accuse their counterparts of lack of good faith. A dispute arose over the validity of two cash calls in relation to development wells. The Claimant, a minority non-Operator shareholder, disputed the issue of the cash calls relating to those wells. The Defendants had served Default Notices on the Claimant in respect of non-payment of the cash calls. The dispute was referred to ICC arbitration.

The Claimant sought and obtained an interim injunction from the English court to prevent the Defendants relying on the Default Notices to exclude the Claimant from, *inter alia*, OpCom decision making, pending the arbitration. Nevertheless, after the grant of the injunction, the Defendant arranged an OpCom meeting to vote on and agree resolutions including in relation to the development wells in question. The Defendant sought to rely on *other* Default Notices it said were not disputed so as to exclude the Claimant. The Claimant was not invited to participate in the meeting, and was only given three minutes’ notice of it at all.

The Claimant successfully argued at first instance that there was a breach of the injunction amounting to contempt of Court. The Defendants maintained that they had acted pursuant to legal advice that their conduct did not amount to a breach of the injunction. The Defendants appealed to the Court of Appeal, where they also lost. The Court of Appeal found that there had been the “*clearest possible breach*” of the injunction, and that reliance on legal advice went only to mitigation and *bona fides*, not to whether contempt had been committed or not. The

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correct course of action would have been for the Defendants to return to court for clarification of the scope of the injunction.

Both *Pan Petroleum* and *Spirit Energy* were heard at first instance by Mr Justice Knowles, and in both instances the Court of Appeal upheld the first instance decisions. However, some crucial differences in both approach and outcome can be seen between these two cases. *Spirit Energy* has been viewed a clear victory for the Operator side; *Pan Petroleum* was a victory for the non-Operator. But the differences are more than just superficial.

While the result itself turned on the relatively wide wording of the injunction, the key significance of *Pan Petroleum* is that it exemplifies the “in principle” availability of injunctive relief in favour of non-paying non-Operators. Restraining the Operator’s remedies erodes the “*pay now, argue later*” principle; a non-Operator can avoid the contractually agreed consequences of non-payment. The incentivisation for non-Operators arising from the Operators’ default remedies lies in their potential harshness i.e. loss of voting rights, production rights and then *a fortiori* forfeiture. But it is this very harshness that may, when the Court is

considering whether to grant injunctive relief, tip the “balance of convenience” in favour of the non-Operator, at least for the short to medium term.

This may be contrasted with the emphasis placed in *Spirit Energy* on the “*Hold Neutral*” principle for the Operator. By allowing a non-Operator to avoid the harsher aspects of fall-out from non-payment, an Operator may not be held neutral (at least in the short to medium term).

On one view, it is difficult to reconcile the availability of such injunctive relief with the supposed absolute obligation to meet cash calls which underlies the “pay now, argue later” principle.

Similarly, an implied tension can be seen between the approach to good faith in these two cases. In *Spirit Energy*, the Court of Appeal looked to good faith duties on the Operator as a protective measure preventing abuse of non-Operators. A certain degree of confidence that the parties would conduct themselves in good faith is implicit in the Court of Appeal’s reasoning. By contrast, in *Pan Petroleum*, good faith was not a sufficient

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protective mechanism: Court orders were needed.

Further, the Court orders actually overrode the contractually agreed remedies in *Pan Petroleum*. This is arguably at odds with the detailed contractual interpretation approach adopted in *Spirit Energy* where the focus was on the primacy of the agreement reached by the parties, even if that case was concerned with final (not interim injunctive) relief.

There is, therefore, some tension in the Court's approach to the overriding approach to regulating the interconnected relationships between Operator and non-Operator in JOA. It could be said that these two cases do not display an entirely harmonious approach to the balance between Operator and non-Operator.