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The flight of the operators: Resignation provisions under joint operating agreements

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"The Devil is in the details, but so is salvation"

So said Admiral Hyman G Rickover, regarded as the father of the United States' nuclear powered navy. It is with similar sentiments that both operators and non-operators in the upstream oil industry are increasingly turning to the terms of their joint operating agreements to establish the nature and extent of their rights and liabilities in the context of *"one of the most dramatic price movements of recent times that has changed the corporate landscape for oil companies"*. [1] This short article explores one specific aspect of this changed landscape for oil companies, one which our clients are increasingly seeing: the rights and obligations of parties to a joint operating agreement ("JOA") in circumstances where the operator seeks to resign (but does not wish to transfer its participating interest; transfers of interest will be the subject of a forthcoming note).

The flight of the operators

The new oil price environment has resulted in both operators and non-operators of oilfields reassessing the commercial viability of those fields. Given the greater liabilities and substantial obligations attaching to the operatorship, this reassessment is of course a particularly acute issue for operators. Although it is difficult to get any industry wide sense of this trend, the writers have recently advised on a number of cases involving operator resignations and anecdotal evidence seems to confirm that this is increasingly becoming an issue.

The framework for operator resignations

This article will primarily analyse the framework for operator resignations under the AIPN's 2012 Model International Joint Operating Agreement ("2012 JOA") although, where relevant, comparisons will be made with other standard forms.

1 http://www.ft.com/intl/topics/themes/Oil

The right of resignation

The basic right of resignation is set out in Article 4.9 of the 2012 JOA – this confers on the operator a right to resign by notifying its partners at least 120 days before the effective date of the resignation, subject to compliance with Article 4.11, which sets out, *inter alia*, the procedure for appointing a successor operator.

A preliminary, but important, point worth making is that the notice required under Article 4.9 needs to comply with the 2012 JOA's notice provisions. The introductory sentence of Article 17.1.A of the 2012 JOA, which deals with the form of notices, begins with the following language *"[e]xcept as otherwise specifically provided, all notices authorized or required between the Parties by any of the provisions of this Agreement…*" Since the notice of resignation is "*required*" by Article 4.9, such notice must comply with the requirements of Article 17. Those requirements include, *inter alia*, that the notice be in writing and in English.[2] Further, a notice is "*deemed to have been properly given*" when addressed to a specified physical, facsimile, or email address[3] and it is deemed delivered only when received by the recipient.[4]

Complying with the notice provisions will prove particularly important where English law is selected as the governing law of the JOA. A two-stage process generally applies to assessing the compliance of a notice with contractual requirements under English law: (i) first, one must construe the notice in order to determine its meaning (for example, whether or not it is clear from the words used in the notice that the operator is exercising its right to resign); and (ii) second, the notice must then be judged against any formal requirements in the contract (such as service at a specified address).[5] Whilst there is some room for manoeuvre as to the construction of the language of the notice,[6] the courts generally adopt a stricter approach with regard to notices that do not meet formal service requirements.[7] As Lord Hoffmann famously put it:

> "If the clause had said that the notice had to be on blue paper, it would have been no good serving a notice on pink paper…"[8]

Where French law is chosen as the governing law of the JOA, the assessment also involves verifying whether the notice complies with the contractual requirements; so again failure to comply may result in invalidity of service much like the situation under English law.[9] With respect to the formal requirements, it is worth noting that the French 2016 Reform on Contract Law confirms that an electronic communication has the same evidentiary weight as a manuscript medium.[10]

Beyond serving the notice correctly, Article 4.9 requires that the outgoing operator give notice to the other parties "*at least one hundred and twenty (120) Days before the effective date of such resignation.*" The language does not make it explicitly clear when this 120 day period starts to run – is it the date of the notice or the date when the notice is deemed delivered under Article 17.2? Given that: (i) delivery is deemed to occur when the notice is actually received by the intended recipient; and (ii) the purpose of the notice is, at least on one level, to make the other parties aware of the resignation (such that they can take appropriate steps in response), it seems more logical for the 120 day period to begin running from the date of delivery, deemed or otherwise.

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2 Article 17.1.A 2012 JOA

3 Article 17.1.A.1-17.1.A.3 2012 JOA

4 Article 17.2 2012 JOA

5 *Trafford Metropolitan Borough Council v Total Fitness UK Ltd* [2002] EWCA Civ 1513, para. 49

6 For which the so-called Mannai principle – that minor defects will not invalidate the notice if the intended operation of the notice would have been obvious to a reasonable recipient, with knowledge of the relevant factual background – applies (*Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] A.C. 749)

7 See, for example, *Claire's Accessories v Kensington High Street* [2001] PLSCS 112

8 *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] A.C. 749, at 776

9 P. Malaurie, L. Aynès, P. Stoffel-Munck, *Droit des obligations* (2015), p. 467, para. 885; See for example the analysis of the conditions for a regular notice by a lessor to terminate the loan: A. Reygrobellet, Ch. Denizot, Dalloz action 'Fonds de commerce' (2012) Chap. 33, Sect. 4 'Obligations pesant sur le bailleur: notification de la résiliation', para. 33.132

10 The French Reform, Ministry of Justice, Ordonnance No. 2016-131, 10 February 2016, provides for a new Article 1366 of the Civil Code: "*L'écrit électronique a la même force probante que l'écrit sur support papier* […]."

Nature abhors a vacuum: Identifying a successor

Assuming that the outgoing operator has correctly served the notice and given the appropriate period of notice, the question becomes: who will thereafter assume the role of operator? This is addressed by Article 4.11.A of the 2012 JOA, which reads as follows:

> "The Operating Committee shall meet as soon as possible to appoint a successor Operator under the voting procedure of Article 5.9. No Party may be appointed successor Operator against its will."

What emerges from this provision is that there is no express contractual requirement on any of the JOA parties to step up and assume the operatorship. Nor, as will be seen shortly, can such an express contractual requirement be found in the remainder of Article 4.11. There is, at least on one reading of Article 4.11.A, a contractual obligation on the JOA parties to convene a meeting of the operating committee in a timely fashion. However, the express language of the provision makes clear that no JOA party can be appointed successor operator against its will; the corollary of this is that each JOA party has a right to express its will not to assume the operatorship, which has consequences of its own.

If that is correct, one is then left in the position where the outgoing operator has served a notice of resignation but there is no successor among the JOA parties to take his place. What then?

Various solutions have been suggested. For example, it has been argued that "*the parties should move towards surrender of the concession and the JOA, on the basis that their continued performance can no longer be effected*".[11] However, this approach carries legal and practical difficulties. In the first place, if it is true that the continued performance of the JOA can no longer be effected, the JOA could arguably (if governed by English law) be discharged automatically by frustration.[12] The question of the parties voluntarily terminating the JOA would not arise. This is of course likely to be a commercially unsatisfactory conclusion – there are a variety of possible reasons why another party might wish to continue to pursue the project as a non-operator but not assume the operatorship. For example, non-operators may feel that they lack the expertise or experience required to discharge the operator's functions.

Another possible solution is obviously for the JOA parties to seek to appoint a third party as operator. There is nothing in the express wording of Article 4.11.A which prevents this; nor on the other hand is there anything expressed in support of such a conclusion. It may be that this involves a purely voluntary exercise (more on that below). If this approach is adopted, then the JOA parties will need to consider carefully how to implement the handover. In the first instance, there may be a requirement to obtain government consent under the underlying concession agreement.[13] Second, the third party will either need: (a) to accede to the JOA and the underlying concession agreement; or (b) to execute a separate contract with all the parties to the existing JOA outlining the rights and obligations of that operator.

We have seen a number of cases where a new operator signs on to a new project vis à vis the outgoing operator, but does not execute a new JOA, which seems surprising but is often driven by expediency. Without a formal accession or a new contract, the third party operator will likely be unable to avail itself of any of the important operator rights and protections under the JOA (for example, the limitation of liability provisions in Article 4.6 2012 JOA) or enforce the same against the exiting JOA partners. Article 20.6 2012 JOA makes clear the somewhat obvious point that only those entities which are parties to the JOA are conferred with the contractual rights it establishes.[14] Furthermore, whilst, as matter of English law, the obligations upon the operator set out in the JOA might bind a third party operator by virtue of an agency relationship or separate oral contract, the default position, pursuant to the doctrine of privity of contract, will be that a third party

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11 Roberts, P. *Joint Operating Agreements, Third Edition* (Globe Law and Business) 2015

12 *"[a] contract may be discharged on the ground of frustration when something occurs after the formation of the contract which renders it physically or commercially impossible to fulfil the contract*"; Chitty on Contracts (Sweet & Maxwell, 31st edition, 2012), paragraph 23-001

13 See, for example, Article 7.2 of the 2010 model production sharing contract issued by the Indian Ministry of Petroleum & Natural Gas ("*No change in the Operatorship shall be effected without the prior written consent of the Government and such consent shall not be unreasonably withheld.*"). Available: http://petroleum.nic.in/docs/rti/MPSC%20NELP-IX.pdf

14 Also see the optional provision for English governed JOAs, which specifically references the Contracts (Rights of Third Parties) Act 1999. Under that Act, a third party can enforce a contract term if the contract in question expressly confers such a right on the third party or if the term purports to confer a benefit on the third party. The optional provision seeks to prevent any of the JOA rights being conferred on third parties via these methods.

operator is not bound.[15] The same is true of French law, which makes clear that pursuant to the legal principle of privity of contract[16] third parties cannot be bound by a contract,[17] except where there exists an agency relationship.[18]

If a third party operator cannot be found, what then? Whilst the 2012 JOA is silent, some JOAs require that the outgoing operator remain in post until the appointment of a successor is achieved.[19] Others, such as the AMPALA JOA, require that the JOA party holding the largest participating interest act as interim operator until such time as a new operator can be appointed.[20] Of course, in most cases that is likely to be the outgoing operator, unless it has also farmed out of the project. Is it arguable that a term along either of these lines could be implied into the 2012 JOA?

The test for implying terms under English law was recently discussed by the Supreme Court in *Marks and Spencer plc v BNP Paribas*.[21] In simple terms, the following conditions must be satisfied in order for a term to be implied:[22]

- it must be necessary to give business efficacy to the contract (meaning a term will not be implied if the contract is effective without it); or it must be so obvious that 'it goes without saying'; and
- it must be capable of clear expression; and
- it must not contradict any express term of the contract.

Furthermore, implication is not dependent on the actual intention of the parties – it is a question of what notional reasonable people in the position of the parties at the time of contracting would have agreed.[23] The term to be implied must either be the only contractual solution or the solution which would "*without doubt have been preferred*".[24]

French law is not acquainted with an 'implied terms' test. Rather, French contract interpretation rules primarily focus on refining the parties' common intention which may lead to identifying tacit obligations.[25] Where the common intention of the parties cannot be identified, the French 2016 Reform on Contract Law has incorporated an alternative standard by reference to a reasonable person in like circumstances.[26] As such, the

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15 Chitty on Contracts (Sweet & Maxwell, 31st edition, 2012), paragraph 18-139. In addition to agency or an oral contract, depending on the terms of the JOA, tortious liability may exist should the third party operator not discharge the obligations contained in the JOA. However, these are complex and uncertain legal questions. It is preferable, therefore, to have a clear and explicit undertaking to comply with the operator's obligations in the JOA.

16 Article 1165 of the French Civil Code expressly provides for privity of contracts.

17 P. Malaurie, L. Aynès, P. Stoffel-Munck, *Droit des obligations* (2015), pp. 408-409, para. 791

18 P. Malaurie, L. Aynès, P. Stoffel-Munck, *Droit des obligations* (2015), pp. 409-410, para. 792. While French law subsumes the principle of '*opposabilité*', i.e. that a contract can be relied upon against third parties, this is likely to fall far short of protecti,g a third party operator to the extent it would deem sufficient

19 AAPL JOA, clause 4.3

20 AMPALA JOA, clause 6.4(c)

21 [2015] UKSC 72

22 See *Marks and Spencer plc v BNP Paribas*, [2015] UKSC 72, paras. 17-21; *BP Refinery (Westernport) Pty Ltd v President, Councillors and Ratepayers of the Shire of Hastings* (1977) 52 ALJR 20; and *Philips Electronique Grand Public SA v British Sky Broadcasting Ltd* [1995] EMLR 472

23 *Marks and Spencer plc v BNP Paribas*, [2015] UKSC 72, para. 21

24 *Philips Electronique Grand Public SA v British Sky Broadcasting Ltd* [1995] EMLR 472, at 482

25 P. Malaurie, L. Aynès, P. Stoffel-Munck, *Droit des obligations* (2015), pp. 393-394, para. 772; *e.g.* Cass. Civ., 21 November 1911, *Cie générale transatlantique*, which recognized the existence of a tacit safety obligation for the transport company towards the traveler. Further the French *Cour de Cassation* has also admitted the existence of an obligation for a seller to inform the buyer whose expertise does not allow sufficient knowledge relating to the purchased good; e.g. Cass. Civ. 1, 3 July 1985, No. 84-10875

26 The French Reform, Ministry of Justice, *Ordonnance* No. 2016-131, 10 February 2016, provides for a new Article 1188 of the Civil Code: "The contract is interpreted following the parties' common intention rather than stopping at the literal meaning of its terms. Where such a common intention cannot be discerned, the contract is interpreted in light of the meaning that a reasonable person in a like situation would give to the terms." (free translation) ; official French version: "*Le contrat s'interprète d'après la commune intention des parties plutôt qu'en s'arrêtant au sens littéral de ses termes. Lorsque cette intention ne peut être décelée, le contrat s'interprète selon le sens que lui donnerait une personne raisonnable placée dans la même situation.*"

new French contract law appears to have adopted set of rules more favourable to accepting implied terms; some would argue this seems to be adopting an approach somewhat akin to that of English law.[27]

Given these tests, whether a term can be implied will depend on the precise facts of any given situation. However, it would seem possible to argue that a term requiring the outgoing operator to stay, or a term requiring the JOA party with the largest participating interest to step up in the interim, should be implied. Under the English law test, such terms are capable of clear expression, arguably do not contradict any express term of the 2012 JOA (if Article 4.11.A is read as meaning no party can be appointed as a *permanent* successor operator against its will), and are (on one view) necessary to give business efficacy to the JOA. In respect of that last condition, in *Marks and Spencer plc v BNP Paribas* Lord Neuberger noted that it may help to ask the question – does the contract lack commercial or practical coherence without the term?[28] In at least one sense, the 2012 JOA arguably does lack such coherence – as noted above, under the JOA parties may be unwilling to take on the operatorship but remain otherwise committed to continuing to pursue the project. In those circumstances, it does not seem coherent that the contract provides no answer or, alternatively, that the project must come to an end.

In light of the recent regulatory developments in French contract law one can note a tendency to adopt concepts closer to the ones existing in English law. It thus stands to reason that the English law criteria for a term to be implied could work under French contract interpretation rules, as long as those terms are not legally required to be expressly stated in the contract (*e.g.* personal subrogation).[29]

Transferring the operatorship

If a notice of resignation has been served correctly, the appropriate period of notice has elapsed, and a willing successor has been found, attention turns to the mechanics of the transfer. Pursuant to Article 4.11.D 2012 JOA the outgoing operator and the successor are required to arrange "*to take an inventory of all Joint Property and Hydrocarbons*". This is to be completed (where possible) no later than the effective date of the change in operator and is subject to the approval of the operating committee.

Provision is also made for an audit to occur, although the audit requirement in this context appears only to apply to situations where an operator has been removed, though little may hinge on this.[30] As regards the transfer itself, the outgoing operator must transfer "*all Joint Property, books of account, records and other documents maintained by Operator pertaining to the Contract Area and to Joint Operations, and shall endeavor to transfer rights, warranties, indemnities and duties under contracts and licenses entered into for Joint Operations.*"[31]

The use of the words "*endeavor to transfer*" leaves open the potential for differing interpretations about the extent of the effort the outgoing operator is required to devote to transferring rights, warranties, indemnities and duties. For example, is it equivalent to an obligation to take all reasonable steps, or something more onerous? Finally, the resignation of the outgoing operator and its replacement by the successor operator "*shall not become effective before receipt of any necessary Government approvals.*"[32]

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27 Another noteworthy innovation in French contract law stands in the possibility to revise the contract where its performance is jeopardized; see new Article 1195 of the Civil Code : "*Si un changement de circonstances imprévisible lors de la conclusion du contrat rend l'exécution excessivement onéreuse pour une partie qui n'avait pas accepté d'en assumer le risque, celle-ci peut demander une renégociation du contrat à son cocontractant. […] A défaut d'accord dans un délai raisonnable, le juge peut, à la demande d'une partie, réviser le contrat ou y mettre fin, à la date et aux conditions qu'il fixe.*"

28 Marks and Spencer plc v BNP Paribas, [2015] UKSC 72, para. 21

29 P. Malaurie, L. Aynès, P. Stoffel-Munck, Droit des obligations (2015), p. 394, para. 772

30 Article 4.11.D 2012 JOA: "*The resigning or removed Operator and the successor Operator shall arrange to take an inventory of all Joint Property and Hydrocarbons, and to audit the books and records of the removed Operator.*" [emphasis added] This does not mean that an incoming operator could not request an audit under the ordinary provisions of the Accounting Procedure

31 Article 4.11.E 2012 JOA

32 Article 4.11.E 2012 JOA

Post-transfer

Upon the effective date of transfer, the successor operator succeeds to "*all duties, rights and authority prescribed for Operator.*"[33] Depending on the provision adopted by the parties, under the 2012 JOA, the outgoing operator is "*released and discharged from all obligations and liabilities as Operator*" accruing after: (a) transferring all contracts and data to its successor; or (b) upon a date determined by the operating committee.[34] If option (a) is selected, this raises the possibility that an outgoing operator might comply with its obligation to "*endeavor to transfer*" all contracts but not be discharged from liability because it ultimately fails to do so for a reason beyond its control (for example, because of an uncooperative contract counterparty). In such circumstances, the outgoing operator, may seek a side agreement from the JOA parties confirming that it is released and discharged from all obligations and liabilities notwithstanding the fact that not all contracts have been transferred.

Conclusion

This short article has sought to briefly describe the typical process by which an operator resigns from its role under a JOA. What emerges is that, irrespective of the governing law of the JOA, there are multiple potential pitfalls into which unsuspecting operators or non-operators could fall. Chief amongst these are the necessity of complying with the notification provisions and, particularly pertinent in the current environment, dealing with situations where no successor operator can be found. In the words of Admiral Rickover, each JOA partner will need to pay close attention to the detailed terms of their contract so as to avoid the devil and navigate a commercially sensible path through an operator resignation.

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[33] Article 4.11.E 2012 JOA

[34] Article 4.11.E 2012 JOA, Alternatives 1 and 2