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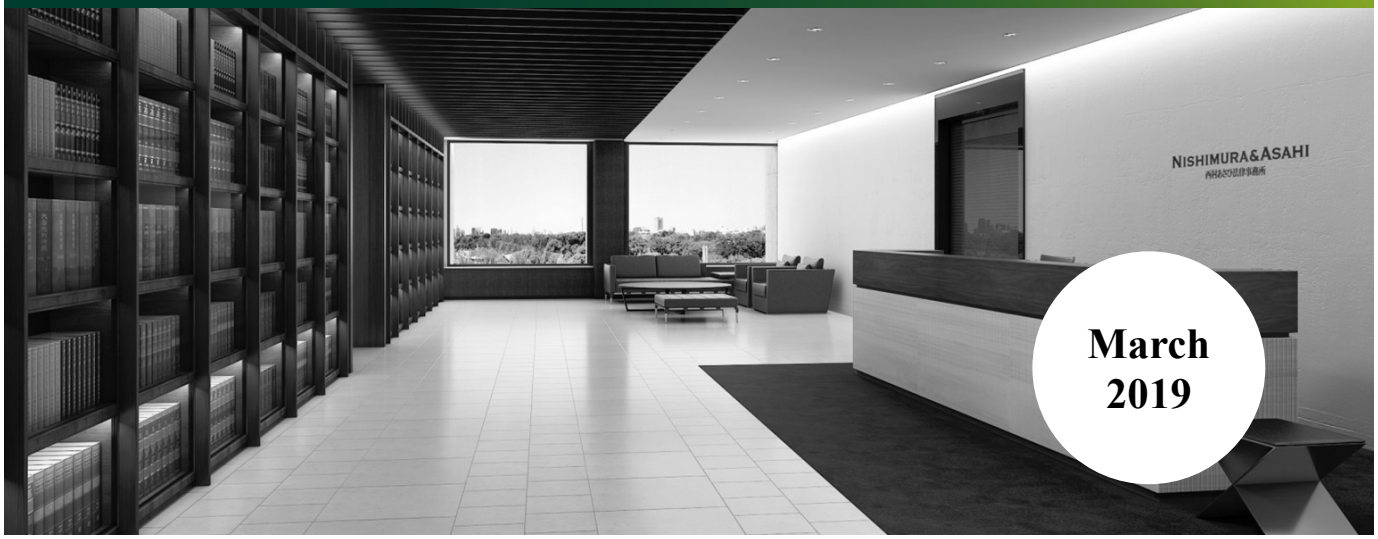

Spirit Energy & TAQA vs Marathon

Mark Tudor

The English Court of Appeal recently considered the extent to which non-operators under a joint operating agreement (**"JOA"**) are liable for their share of liabilities arising out of joint operations under the Brae Fields JOA *(Spirit Energy Resources Ltd & Ors v Marathon Oil UK LLC [2019] EWCA Civ 11)*.

Background

This was an appeal by some of the non-operators (the **"Participants"**)[1] against a finding in the High Court[2] in favour of Marathon Oil U.K. LLC, the Operator.

The liabilities in dispute arose from a deficit in a defined benefit pension scheme[3] offered to employees of the Operator. The Operator hired employees (and provided them a remuneration package including the defined benefit pension scheme) to carry out joint operations which had been approved by the Operating Committee. Over the course of the project, a substantial deficit arose under this pension scheme due to *"macroeconomic volatility in interest rates, bond markets, [and] equities"* and the Operator cash-called the non-operators to fund this deficit through a "deficit recovery charge" (**"DRC"**). A valuation as at 31 March 2013 estimated the DRC to

1 Sprint Energy Resources Limited (formerly Centrica Energy Resources Limited), TAQA Bratani Limited, and TAQA Bratani LNS Limited. JX Nippon was also a non-operator but was not party to the appeal.

2 *Marathon Oil UK LLC v Centrica Resources Limited & Ors [2018] EWHC 322 (Comm)*

3 This is a type of pension scheme that used to be common in the UK under which the employer promises an employee a specified amount of pension upon retirement (determined based on factors such as the employee's salary, length of service, and age). Unlike a "defined contribution" pension plan, it is not linked to returns on any underlying investments into which the employer's and employee's contributions are paid.

exceed £68 million; the Operator claimed that the Participants were liable for 54.41% of this amount.

The Participants argued that they should not be held liable to contribute to future liabilities which were never foreseen or contemplated at the time (years earlier) when the Operating Committee approved and authorised the relevant work programme and budget which resulted in the employment of these staff.

The High Court decided, in favour of the Operator, that *"authorisation of the [DRC] expenditure flowed from the authorisation of the operations, which included the hiring of employees and the accompanying pension provision"*. Permission for the Participants to appeal the High Court's decision was limited to a single ground.

The question for the Court of Appeal to decide was whether the non-operators should be liable to fund their share of the DRC in circumstances where (although the operations in question had been subject to Operating Committee approval) the precise nature and amount of these costs was unforeseen at the time of the initial approval of the relevant operations.

Court of Appeal Decision

The Court of Appeal judgment was given by Lord Justice Green on 17 January 2019. It upheld the decision of the High Court in favour of the Operator and dismissed the appeal.

In determining the issue, the Court of Appeal:

(a) first considered the *"natural and ordinary meaning" of the contractual language of the JOA from the perspective of: "(i) the individual clauses which impose liability upon Participants; (ii) the JOA as a whole and inferences drawn therefrom; and (iii) a purposive construction of the JOA taking into account and applying the principles which the parties have expressly incorporated into the agreement"*; and

(b) then looked at the overarching commercial purpose or *"commercial common sense"* of the JOA arrangements.

What is the "natural and ordinary meaning" of the JOA language?

The JOA required the Operating Committee to agree upon and adopt an operating programme and budget which included the *"requirements of the Operator having regard to previously approved programmes and budgets and its obligations thereunder"*. Lord Justice Green rejected the argument of the Participants that the words *"having regard to"* gave the Participants a discretion as to which of the requirements of the Operator should be included in the budget. Instead, the Court viewed this language as being mandatory and imposing an obligation on the Operating Committee to agree upon and adopt an operating programme and budget which included the costs of matters that the Operator was required to perform under previously approved programmes and budgets.

Lord Justice Green noted that the JOA wording covered a broad category of costs (including pension contributions) and did not contain a distinction between the different types of costs (such as those which were certain and those which were uncertain at the time of the approval). For example, the JOA provided that: (i) except as otherwise set out in the JOA, *"all costs and expenses of all operations… shall* be *borne by the [parties to the JOA]"*; (ii) *"all costs and expenses of whatsoever kind that are incurred in the conduct of operations"* fell within the scope of the costs to be settled under the JOA; and (iii) *"the Operator shall charge the Joint Account for all costs incurred in conducting Joint Operations"*.

Lord Justice Green therefore concluded that the normal and ordinary meaning of the JOA, taking into account its purpose, was that the Participants should bear their portion of the DRC.

What is the "overarching commercial purpose"?

The Accounting Procedure included express wording providing that the overall purpose of the JOA was to equitably allocate costs, benefits, and burdens between the JOA parties and to hold the Operator neutral. The Court of Appeal considered that express inclusion of this wording identified the commercial reasoning behind the JOA.

Did the Operator have a "blank cheque" to incur costs on behalf of the non-operators?

The Participants had argued that the decision of the High Court gave the Operator the ability to write a *"blank cheque"* to spend money on behalf of the non-operators, without the non-operators having any control or protection. The Court of Appeal did not consider that this was the case as:

- The Operating Committee was fully appraised of all of the facts and had authorised the expenditure which led to these pension deficits in operating programmes and budgets. The Participants, through the Operating Committee, had authorised the DRC costs which were consequential upon the approved operating programmes and budgets;
- It was the nature of the operations that the authorisation covered costs which might, at the time of approval, be uncertain in scope and nature. Accordingly, the Accounting Procedure required detailed information on estimates to be provided and the fact that the actual liabilities were more than expected did not alter the fact that, under the wording of the JOA, the Operator had been authorised to cover pension payments, however much these amounts ultimately were; and
- Protection is available at common law if the Operator incurs costs in bad faith or dishonestly.

Comments

The judgment of the court relies heavily on the specific wording of the Brae JOA and accordingly a different outcome could be reached under a JOA with differing wording. The case does, however, provide guidance on how the English courts will interpret JOA's, which will be helpful to Operators and non-operators in assessing their liabilities.

It is worth noting that the JOA in question is almost 40 years old (it was signed in 1980) and did not contain some of the protections that are found in more recent JOA's (such as limitations on the ability of the Operator to overspend on budgets and work programmes without reverting back to the Operating Committee for further approval of expenditure above a set limit). Accordingly, the decision may be of limited effect. However, non-operators with legacy JOA's (especially in respect of assets which are close to the end of their commercial life) might like to review these to assess if the JOA wording could result in liability for unforeseen costs arising out of historic approvals of operations.

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*Please note that we are not engaged in a Gaikokuho Kyodo Jigyo (the operation of a foreign law joint enterprise).

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