

INSIGHTS

What Constitutes a Reasonable and Prudent Operator?

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By: [Darren Spalding](#)

The English Commercial Court interprets the definition of the standard of a "Reasonable and Prudent Operator"• in the context of a dispute relating to long term gas sales agreementsThe phrase "reasonable and prudent operator" is frequently used in commercial contracts in the oil and gas industry to specify the standard at which a party must perform a particular obligation (or group of obligations). Helpfully, contracts often define the phrase in order to give the content of that standard greater substance, albeit a definition that inevitably imports a degree of subjective judgement. In a recent case (*Scottish Power UK Plc v BP Exploration Operating Company Ltd & Ors* [1]), the Commercial Court decided a number of preliminary issues in the context of long term agreements for the sale of natural gas, including the interpretation of the definition of a reasonable and prudent operator ("RPO"). The first instance decision provides operators with some guidance as to issues they should contemplate when agreeing to act as an RPO, not least because the definition in question in the case follows a common formulation.

Background Scottish Power entered into four long-term agreements (on materially identical terms) under which it agreed to purchase from the defendants (BP Exploration Operating Company Limited, Talisman Sinopec North Sea Limited, ENI TNS Limited and JX Nippon Exploration and Production (UK) Limited) (the "Sellers") natural gas produced from the Andrew Field in the North Sea. The Sellers' obligation to deliver an amount of natural gas in accordance with Scottish Power's proper nomination was contained in Article 6.12 of the Agreements, which provided that: *"the Seller shall deliver on each Day at the Delivery Point the quantity of Natural Gas properly nominated by the Buyer under this Agreement for delivery on such Day."* Article 7 then imposed obligations throughout the contract period on the Seller to act in accordance with the RPO standard: *"Throughout the Contract Period the Seller will, in accordance with the Standard of a Reasonable and Prudent Operator, provide, install, repair, maintain and operate those Seller's Facilities which are (in the opinion of the Seller and the other Sellers) necessary to produce and deliver at the relevant times the quantities of Natural Gas from the Andrew Field which are required, in accordance with the terms of this Agreement, to be delivered to the Buyer at the Delivery Point."* RPO was defined in Article 1 as: *"a Person seeking in good faith to perform its contractual obligations and, in so doing and in the general conduct of its undertaking, exercising that degree of skill, diligence, prudence and foresight which would reasonably and ordinarily be expected from a skilled and experienced operator engaged in the same type of undertaking under the same or similar circumstances and conditions, and the expression the 'Standard of a Reasonable and Prudent Operator' shall be construed accordingly."*

Production of natural gas was shut-in for a period of over three and a half years, between 2011

and 2014, so that work could be done to tie-in the nearby Kinnoull Field to the Andrew platform. The Sellers stood to gain in economic terms from the tie-in project. Scottish Power issued proceedings against the Sellers claiming, inter alia, that during the shut-in period, the Sellers were in breach of their obligation under Article 7 to act as an RPO. Scottish Power's case was that in deciding to shut-in the Andrew Field to carry out the works, the Sellers did not comply with the RPO standard because, in so doing, they were not seeking to perform their contractual obligations to deliver natural gas to Scottish Power but were taking a deliberate decision not to do so. The Sellers sought to argue that by shutting in the field to facilitate the tie-in of the Kinnoull Field they were acting in compliance with, and taking account of their duties under, energy legislation and the industry Code of Practice on Access to Upstream Oil and Gas Infrastructure on the UK Continental Shelf ("ICOP"). With regard to the RPO standard, the Sellers contended that what mattered was whether a skilled and experienced operator in the position of the Sellers exercising that degree of skill, diligence, prudence and foresight which would reasonably and ordinarily be expected from such an operator would have acted as they did. They submitted that such an operator would have sought to comply with and take account of (a) ICOP and (b) the possibility of a referral to the Department of Energy and Climate Change if they did not comply with ICOP and, in the light of those factors, would or could have decided to shut down the Andrew platform to carry out work to tie in the Kinnoull Field. That was sufficient, they argued, to show that they had complied with the RPO standard. **Decision** Mr Justice Leggatt considered the interpretation of the definition of RPO. In rejecting the Sellers' arguments, he said that there was nothing in the language of the definition of RPO to support an interpretation that ICOP or statutory obligations had a role to play in deciding whether the Sellers had acted in accordance with the RPO standard for the purpose of the agreements. He was unwilling to use the factual matrix to alter the natural and ordinary meaning of the RPO obligation which required the Sellers to seek to perform their contractual obligations. As the decision to shut-in production was a purposeful decision not to provide services during the tie-in period, it was a breach of the RPO standard. Mr Justice Leggatt recognized that he was giving a literal interpretation to the text of the definition but felt justified in doing so on the basis that the definition was "*quite elaborate and gives the impression of having been carefully formulated*" and stating he saw "*no reason to suppose that it was drafted by a Mrs Malaprop*". **Comment** The RPO definition in this case (and others that closely resemble it) is widely used in long term energy contracts. Parties often agree to its inclusion without considering the wording in any great detail or what circumstances could potentially give rise to breach. The Commercial Court's decision is a timely reminder to operators to carefully consider the scope of the obligations by which they are bound. This is even more critical in the context of long term energy agreements where surrounding commercial considerations and operations may change over time. At the very least, this case indicates that operators should consider whether the RPO standard to which they are subject should contain an exclusion in relation to legislative requirements or codified industry practice. This case also confirms that the English court will approach the interpretation of long term oil and gas contracts in the same manner as any other commercial contract, taking account of (i) the natural and ordinary meaning of the clause in question; (ii) any other relevant provisions of the contract; (iii) the overall purpose of the clause and the contract; (iv) the facts and circumstances known or assumed by the parties

at the time that the document was executed; and (v) commercial common sense. [\[1\]](#) [2015] EWHC 2658 (Comm)