

JOA Defaults Reconsidered

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In the recent decision of *Pan Petroleum Aje Ltd v Yinka Folawiyo Petroleum Co Ltd & Ors* [2017] EWCA Civ 1525, the Court of Appeal upheld a decision of the High Court that parties to a Joint Operating Agreement (“JOA”) could be temporarily prevented from excluding an alleged defaulting party from participating in, or voting in, any operating committee meetings pending resolution of a dispute.

The decision is likely to be of great interest to those conducting joint operations as it could frustrate the ability of parties to exercise remedies under default provision of many JOAs.

Background

Pan Petroleum Aje Limited (“Pan Petroleum”), Yinka Folawiyo Petroleum Co Ltd (“Yinka”) and the other defendants were all parties to a JOA in respect of an oil mining lease offshore Nigeria. The JOA contained the usual provisions in relation to the establishment of a Joint Operating Committee (“JOC”) and issuance of ‘cash calls’ to the parties to meet their respective shares of funding obligations, based upon a budget that was approved by the JOC for operations.

A dispute arose in relation to whether the development of two new wells had been properly approved. Pan Petroleum opposed draft resolutions put forward to the JOC in relation to the first well, maintaining that drilling of such a well was premature and that the decision required unanimous approval of the JOC. Pan Petroleum was subsequently considered to be a “Defaulting Party” under the JOA for failure to pay its cash calls in respect of the proposed new well.

Pan Petroleum was successful in its application for an injunction to restrain the defendants from exercising default rights under the JOA until the dispute had been resolved by arbitration.

However, three days following the continuation of the injunction, a meeting of the JOC was held at which a number of matters were voted on, including the approval of cash calls in respect of a second new well. Pan Petroleum was not invited to participate. Pan Petroleum subsequently commenced contempt proceedings, seeking declarations that the purported resolutions were illegal and void as a matter of English law.

The High Court held that it was plain beyond argument that the other JOA parties’ actions excluded Pan Petroleum from participating in, and voting at, the meeting. The court also considered whether their actions were “in respect of” the disputed wells on a literal interpretation of the injunction. The court subsequently found that the parties were in breach

of the injunction and in contempt of court as excluding Pan Petroleum from participating in a meeting approving the cash calls or budget for work on or with a well is exercising or purporting to exercise that right “in respect of the well”.

On appeal, the court upheld the findings of the High Court.

Analysis

The judgment largely focuses on the correct construction of the injunction and whether the appellants were in contempt rather than on the merits of Pan Petroleum’s claim and whether the injunction should have been granted or the terms upon which it was granted. However, the implications of the decision are likely to have a greater significance to parties to a JOA.

Under the terms of the JOA in dispute, the consequences for the Defaulting Party if a cash call remains unpaid when due are two-fold. First, after 5 business days, the Defaulting Party is excluded from the JOC and, second, after 45 days the Defaulting Party may be required to withdraw from the JOA. A party disputing a cash call (and thereby becoming a Defaulting Party by failing to pay) therefore takes the risk that the other parties may be able to exercise those remedies under the default provisions during the period of dispute. The fact that an injunction was granted in the initial hearing by the High Court, and the terms of it then enforced by the Court of Appeal in the subsequent hearing, suggests that the English courts are not opposed to intervening until a dispute is resolved between the parties. Such a position could have significant consequences for both any Defaulting Party and the non-Defaulting Parties under a JOA.

It is not uncommon for cash calls under a JOA to be disputed or unpaid, and it is often difficult to reach agreement on approving work programs and budgets, particularly if there is a large number of parties to the JOA. It appears that non-Defaulting Parties must now accept that, if a cash call is in dispute, they may be restrained from exercising any remedies against a Defaulting Party, including its exclusion from meetings or decision-making of the JOC or, just as importantly, requiring it to withdraw from the joint venture (either completely or on a “withered” basis, depending on the nature of the default remedies under the JOA in question). This has the potential to create a lengthy period of uncertainty – or at least for a duration not typically envisaged by the language of the JOA – and to have an adverse impact on operations during such period.

For any allegedly Defaulting Party, there is arguably an extension of its rights under the JOA beyond the usually strict language of the default remedy provision or, at least, the ability to safeguard its rights if it considers that it is being cash called for amounts under a work program and budget that has not properly been agreed. This may be welcome news for smaller, non-operator companies seeking to avoid being “squeezed out” by larger operators in circumstances where there is ambiguity over decision-making thresholds for undertaking material expenditure. The clear lesson for operators, then, is that clarity of drafting in relation to such decision-making for work programs and budgets continues to be vital, so as to minimise the risk that a disagreeing party will refuse to pay a cash call and effectively grant itself an extension to the time periods set out in the JOA by commencing proceedings in relation to the disagreement and seeking an injunction to protect that position.