



“Some key legal aspects related to allocation –
From contract negotiation phase to cessation”

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- Introduction
 - NCS legal framework – basic starting points
 - Contract negotiation phase
 - Quality of drafting
 - Use of standard agreements
 - Agreements to “agree X months prior to start-up” - soft language
 - Contract execution phase
 - Formalized amendments or informal changed practice with legal effects
 - Typical disputed issues in re-allocation cases
 - Commercial risks associated with re-allocation claims

- Allocation;
 - Practices of breaking down measures of quantities of extracted hydrocarbons across various contributing sources
 - Correct allocation: Allocated volumes reflect the real ownership share of each owner
 - Typically a joint production regime under a tie-in agreement leads to commingling of petroleum from different owners
 - Factual/technical elements: Methods/formulas using input from metering equipment to allocate “correctly”
 - Commercial/legal: Contract regulations and dispute resolution to get correct ownership share
- Re-allocation
 - Re-allocation: Making up for errors (formulas not followed or errors in metering)
 - Subject to dispute in many cases, often with high values at stake
 - Timing of re-allocation, in kind, value/price, for which periods, will a re-allocation claim be statute barred
- Scope: “Discuss” some key legal aspects
 - Contract negotiation phase including amendments/re-negotiations
 - Contract execution phase; Typical legal issues associated with re-allocation claims
- Not within scope: Metering (and uncertainties), value adjustment, allocation procedures

NCS legal framework – basic starting points (1)

- The Petroleum Act (“PA”) Section 3-3 third section:

“A production licence entails an exclusive right to survey, exploration drilling and production of petroleum deposits in areas covered by the licence. The licensee becomes the owner of the petroleum which is produced.”



Key principle: Ownership right established - “right in rem”

- The JOA Article 6

“Each Party shall own an ideal share of the capital assets, including rights of any kind which have been acquired or developed by the Operator or by any of the Parties on behalf of the joint venture. This also applies to produced Petroleum which has not been disposed of by any Party. The size of the ideal share is equal to the Participating interest.”

- Allocation under the JOA based on same as the PA Section 3-3 - each participant shall be allocated its “ideal share”

NCS legal framework – basic starting points (2)

- If commingling of petroleum from different sources/fields - need for an agreed allocation regime:
 - Tie-in agreements (“TPA”), transportation and processing agreements
 - Joint development and co-ordination agreements; joint investments in infrastructure
 - UOA different; “unitization” of ownership rights and allocation as per the JOA and re-allocation after re-determination
- Key considerations for allocation:
 - Each owner shall be allocated his ownership share of the commingled stream (zero-sum game)
 - Correct allocation more important consideration than final settlement
 - Never ending story? However, see GTC Article 17 with 6 years limit
- Legal basis for a “*fair and correct*” allocation and correspondingly a right to re-allocate if errors:
 - Ownership
 - The agreement itself
 - General contract law principles/loyalty principles (particularly strong weight under long-term agreements)
- A right to re-allocation can be established even if no firm basis is stated in the agreement

- Quality of the allocation procedures the result of
 - Sufficient time available for negotiations and for quality assurance
 - Competencies of the persons involved
 - Access to information/data about the petroleum streams/sources
 - Access to and use of standard provisions
- Drafting is team-work between disciplines
 - Examples of that not all professions are keen on being heavily involved on drafting allocation procedure
- Observations:
 - Lack of clarity and ambiguity might be the result; (“it is intended”, “necessary updates”, “unfair allocation”)
 - Room for improvement of cooperation between various disciplines
 - High values involved and long term agreements; suggest that quality of drafting should be maximized
 - Lack of; traceable minutes of meetings, contract drafts and recordings from negotiations

Contract negotiation phase – Use of standard agreements (1)

- Of particular relevance are the General Terms and Conditions (“GTC”) for third party use which is relevant
 - http://www.npd.no/Global/Norsk/5-Regelverk/Skjema/Andres-bruk-av-innretninger/Standard_avtaleklausuler.pdf
 - Approved by the MPE; basis for all TPAs
 - Most of the main provisions are set whilst appendices are left “open”
- GTC Article 17
 - Significantly developed in latest revision of the GTC
 - Governs “Measurement, testing, sampling, allocation, reallocation and value adjustment”
 - GTC Article 17 the basis for Appendix C to be established within the frame of Article 17, ref. Article 2 which provides for that the main body prevail in case of conflict with Appendix C
- GTC Article 20 governs allocation of fuel and flare; some amendments but mainly the same as previous GTC;
 - Allocation based on “pro rata use” as compared to “pro rata share of actual throughput”
- A “dive” into some of the paragraphs of the GTC Article 17 for illustration

Contract negotiation phase – Use of standard agreements (2)

- GTC Article 17 (my underlining)

17.1 Measurement, testing, sampling, allocation, re-allocation and value adjustment shall be performed in accordance with relevant laws and regulations and in accordance with fair and prudent principles and standards. The allocation of petroleum to the User shall reflect the petroleum produced from the User Field.

17.2 The Groups shall establish procedures to achieve the purpose set out in the above paragraph as soon as practically possible upon the entering into of this Agreement and in any event no later than three (3) months prior to Commencement Date. Such procedures shall be set out in Appendix C.

17.3 The User has the right to witness calibration and meter proving and to observe the operation of all relevant equipment and/or facilities for measurement, testing, sampling, allocation and value adjustment. The Owner shall upon request from the User give notice reasonably in advance of such activities to enable the User to be present as described. The User's participation shall be on the User's own cost and expense.

The User has the right to audit, any and all metering data and other test information applicable to said equipment and/or facilities, which is reasonably necessary to verify the measurement, testing, sampling, allocation, reallocation and value adjustment. The Owner shall accommodate the User's audit within reasonable time upon such request from the User. Audits by the User shall be at the User's own cost and expense.

17.4 If at any time a Group finds that measurement, allocation and/or value adjustment has not been carried out in accordance with Appendix C, such Group shall notify the other Group of such error immediately.

In the event that such error has caused an incorrect allocation of petroleum, this shall be corrected through an in-kind reallocation. If a Group is partly or wholly unable to provide its share of petroleum to be reallocated in-kind, such Group shall settle in cash the part of its share that is not provided in-kind. Such cash settlement shall seek to put the Groups in the same position as if the reallocation had been carried out in-kind.

The Groups shall not be entitled to any compensation due to the incorrect allocation and the corresponding re-allocation, whether due to changes in petroleum prices or otherwise.

17.5 Re-allocation according to Article 17.4, whether in cash or in-kind, shall only apply to petroleum which has been allocated within 6 years prior to the date the error was identified. Any incorrect allocation carried out more than 6 years prior to the identification of the error shall hence not form basis for re-allocation.

The Operator of the Owner has the right and obligation to initiate the reallocation as soon as reasonably possible after an error as described in this Article has been identified and the factual basis for performing a reallocation has been clarified. Further, the Owner shall as soon as practically possible consult and agree with the User on the performance and timing of the reallocation and take remarks from all affected Licensees into consideration.

Contract negotiation phase – Use of standard agreements (3)

- Some key takeaways from GTC Article 17:
 - More than an expression of an intention (as previous GTC provision)
 - Settlement in kind and settlement in money only if a party is “unable”; typically tale-end and when production has ceased
 - No adjustment for value/pricing effects; oil price fluctuations the risk of the parties involved (can go both ways)
 - Cut off after 6 years;
 - Significant new development compared to previous court rulings (i.a. Statfjord judgement from 2010)
 - A compromise between the principle of fair/correct allocation and cut of requirements
- Still relatively few tie-in agreements for fields in production under new GTC and any previous TPAs will be subject to a different mechanism

Contract negotiation phase – Agreements to «agree»/soft language

- GTC Article 17.2 states that the parties shall establish procedures within 3 months before commencement of production. (Previously a 6 months time limit)
- Similarly in appendices to TPAs we have sometime provisions saying that if «material or systematic bias»/unfair allocation with a corresponding effect that a change shall be agreed.
- An agreement to agree something is in principal not a binding commitment beyond acting in good faith/de facto seek agreement. Difficult to enforce specific regulation (agreement)
- Under PA Section 4-8 ref. TPA Regulations, the MPE may determine the terms for the TPA (incl. appendices);
 - Far from clear that the MPE will intervene
- Ways to reduce risks and increase commitment levels:
 - Governing principals/considerations or main terms may be included
 - Inclusion of expert provisions with procedures
- Would it be possible to determine the terms under Appendix C in a dispute under GTC Article 37
 - Unresolved and unclear; Will depend on an interpretation of the GTC

Contract execution phase – Amendments or informal changed practice

- Allocation are often agreed under long term contracts
- Observations in some cases:
 - Informal approach by the parties to contractual mechanisms (non-adherence)
 - Lack of book-keeping and lack of amendments being formalized
- In the long term; the creditor for an amount or an entitlement will have most to loose if an informal approach
 - Good book-keeping is a mean to protect its own contractual positions
- Difficult to improve its own contractual position by an informal approach;
 - Passivity (from the opponent) may however in some cases be dispositive
 - Risk associated with an informal approach
 - And disputes often the results when what is agreed has not been complied will or updated to reflect practice
- If the contract states that changes shall be incorporated by way of amendments, the starting point is that no change is adopted until an amendment is entered into;
 - See GTC Article 34, in some cases also change/amendment provisions set out in Appendix C

Contract execution phase - Disputed issues in re-allocation cases (1)

- Disputes not uncommon;
 - A number of Arbitration awards (confidential)
 - Statfjord judgement from 2010 (appealed to Supreme Court but not aloud to be heard)
 - A number of cases with settlements agreed
- Subject for dispute:
 - Will a re-allocation claim be subject to statutory limitation (standard period under Norwegian law is 3 years)?
 - No, ref. Statfjord judgement and Arbitration judgement
 - Basis: «Right in rem»; A claim of a legal nature not subject to the statutory limitation period
 - (In theory), unless otherwise agreed a recourse may take place at any point in time
 - If agreed otherwise (GTC Article 17), no basis for resource after more than 6 years
 - Shall there be an adjustment for petroleum price fluctuations?
 - No, ref. Statfjord judgement (and other judgements). See also GTC Article 17
 - Risk for creditor in falling marked
 - May agree different mechanisms (not normal)

Contract execution phase – Disputed issues in re-allocation cases (2)

- When shall re-allocation take place?
 - As soon as possible and not subject to speculation
 - If proved that there is a speculation element; the group effecting re-allocation may become liable for losses
- May the operator effect re-allocation without a judgement (in case re-allocation is disputed)?
 - Yes.
- How to resolve other possible effects of re-allocation
 - Opex contribution paid by the party having been allocated too much?
 - Transportation tariffs associated with volumes subject to re-allocation?

Commercial risks associated with re-allocation claims

- “Off balance liability”; typically unknown
- Transfer of interest situation;
 - The agreement (SPA) will normally set an effective date with standard cut-of of Seller’s liabilities
 - A claim for re-allocation coming up later will typically be raised against the Buyer as owner/party to relevant agreement
 - Merits of claims have to be assessed based on the applicable contract (TPA or other basis for re-allocation)
 - If rights and obligations under a contract have been assigned, Seller will normally have transferred risks to Buyer
 - Similarly, in case of transfer of shares; Buyer will assume Sellers position and liabilities
- Risk associated with possible re-allocation/errors in allocation should be subject to assessment on the Buyer side in due-diligences etc. and can be solved with an indemnity from Seller

A re-allocation process often takes a while from “discovery” of error to re-allocation and final dispute resolution.



Questions?

**Thank you for
your attention!**

