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Research Article

Conditions Precedent in Farmout Agreements - An Overview

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Abstract

Conditions precedent to Farmout Agreements (FOA) are critical in ensuring that an agreement is fulfilled under conditions that are protective of the parties' interests in the agreement. Conditions precedent offer parties an escape route from a project if certain approvals are not obtained or if other unexpected circumstances render the project legally or technically infeasible. In the context of FOAs, parties may make their agreement to a project contingent upon governmental approvals, the farmee's timely drilling of wells, or environmental assessments, for example. Generally, if one or several conditions have not been fulfilled by a certain date, the parties may have the right to terminate the contract.

As with any contractual clause, ambiguous or contentious conditions precedent are likely to foment disagreement among parties and may result in disputes. Though many ambiguities can be avoided through precise language and careful drafting, it is not always possible to avoid the host of potential disagreements regarding the correct interpretation of a contract. For seamless resolution of disputes, parties to a FOA must carefully select their FOA model in light of the parties' specific positions and interests.

This article endeavors to provide a limited overview of conditions precedent in FOAs for students and young practitioners, and highlight possible dispute resolution planning techniques for use in practice.

Keywords: Farmout agreement; Condition precedents; Termination; Break-up fees; Material adverse conditions; Dispute resolution

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مقالة بحثية

الشروط المسبقة لاتفاقيات المزارع – نبذة عامة

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ملخص

تعد الشروط المسبقة لاتفاقيات المزارع مهمة حيث إنها تضمن تحقيقها وفق الشروط التي تحمي مصالح أطرافها. وتتيح هذه الشروط المسبقة للأطراف فرصة الهروب من مشروع ما في حال عدم الحصول على بعض الموافقات أو غيرها من الظروف غير المتوقعة التي تجعل المشروع غير عملي من الناحية القانونية أو الفنية. ويمكن أن تُبنى الاتفاقية على موافقات الدولة وذلك وفق رغبة أطرافها، على سبيل المثال الوقت المناسب لحفر الآبار وعمليات التقييم البيئي. وبشكل عام، إذا لم تحقق أحد أو عدة (ال) شروط بحلول تاريخ معين، يحق للأطراف إنهاء الاتفاقية.

وكما هو الحال في أي شرط تعاقدي، من المحتمل أن تؤدي الشروط المبهمة أو المثيرة للجدل إلى خلاف أو نزاع بين أطراف الاتفاقية. وعلى الرغم من تفادي الغموض في نصوص الاتفاقيات من خلال استخدام صياغة لغوية دقيقة، لا يمكن تجنب احتمال الخلافات بشأن التفسير الصحيح للاتفاقية بشكل دائم. ولحل النزاعات بين أطراف اتفاقيات المزارع، يجب على أطراف أي اتفاقية اختيار نموذج الاتفاقية في ضوء مكاناتهم ومصالحهم.

تهدف هذه الدراسة إلى توفير نبذة عامة من الشروط المسبقة لاتفاقيات المزارع للطلبة والممارسين الصاعدين، كما إنها تلقي الضوء على تقنيات تخطيط حل النزاعات وذلك لاستخدامها في الممارسات.

الكلمات المفتاحية: اتفاقية المزارع، الشروط المسبقة، إنهاء الاتفاقية، غرامة خرق الاتفاقية، شروط سلبية مضادة، حل النزاعات

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Introduction

Farmout agreements (FOA) are contracts in the oil and gas industry that permit the owners of petroleum rights to assign some or part of their interest to another party. Although FOAs are prevalent in the upstream oil and gas industry, scholars in the field have not significantly analyzed the role of conditions precedent in FOAs due to the fact that conditions precedent are generally fulfilled in the early stages of a project; or, in the event that a condition precedent is not fulfilled, parties may negotiate a solution or terminate the project before actually experiencing the consequences of non-fulfillment. Moreover, problems involving unfulfilled conditions precedent are usually resolved in confidential fora. This article presents an overview of conditions precedent in FOAs for young practitioners and students, with particular emphasis upon the non-fulfillment of conditions precedent.

Every FOA and its conditions are drafted to serve a specific transaction. It would be impossible to provide an exhaustive analysis of all possible disputes and issues that practitioners may confront. However, before turning to these questions, the paper will provide an overview of the industry practice concerning FOAs in the upstream subsector (including, but not limited to, the definition, standard models, and key clauses of FOAs).

I. International Practices in the Oil and Gas Industry Relating to FOAs

The oil and gas business is an extensive, complex, worldwide industry that involves significant risks. The operations within this sector generally require large amounts of capital, particularly in the upstream sector, which covers exploration, development, and production. Most conventional lending options do not provide the necessary financial backing and commercial lenders are generally not keen to finance upstream activities because of their risky nature. Financing, even when secured, comes with high interest rates for loan servicing.

Title holders of petroleum rights may therefore at some point of the project need to sell or farm-out some or all of the rights that they control through a host government contract.[1] Thus, the industry as a whole has had to develop agreements that not only reduce and spread the risks inherent to its activities but also provide alternative means of funding, all the while accommodating the needs of the different actors that intervene in those activities. This starting point has led oil and gas exploration projects to use sale purchase agreements (SPA) and FOAs.[2] The focus of this paper will be on the latter.[3]

A standard oil and gas FOA can be described as "an agreement by one who owns drilling rights to assign all or a portion of those rights to another in return for performing certain work obligations or paying

1- As states generally own the oil and gas resources in their territories, in the majority of countries around the world, governments grant and assign petroleum rights and obligations to oil and gas companies or a consortium of companies, which become title holders of the assigned rights.

2- On legal instruments in the oil and gas sector, see e.g. John Tarrant, *Agreements to co-operate at common law* (2006) 25 ARELJ 281; Charlotte Wright & Rebecca Gallun, *Fundamentals of Oil & Gas Accounting* (Penwell, Tulsa, 5th ed., 2008); Timothy A. Martin, *Bifurcation of title in international oil & gas agreements*, OGEL 4 (2010); John Wilkinson, *Introduction to Oil and Gas Joint Ventures* (OPL, Ledbury, 1997); G. Foster, *Managing expropriation risks in the energy sector: Steps for foreign investors to minimize their exposure and maximize prospects for recovery when takings occur*, 23 J. Energy & Nat. Resources L., 36–59 (2005); Andrew Derman & Andrew Melsheimer, *Changing the rules of the game: Issues that arise under the 2002 AIPN JOA when a host government mandates a "replacement contract"* OGEL 4 (2010); Waniss Otman, High-level conflict and divergence of control in the Libyan hydrocarbon industry: Risks and uncertainties to IOCs, OGEL 4(1) (2006); Ernest Smith, *World energy resources: Ownership, control and development*, in Ernest Smith et al. (eds), *International Petroleum Transactions* 28 (RMMLF, 2nd ed., 2000); Bernard Taverne, *An introduction to the regulation of the petroleum industry: Law, contracts and conventions* 131 (Graham & Trotman, London, 1994).

3- There is a fairly small distinction between a FOA and a SPA, as both agreements are used as methods of funding oil and gas activities. The acronyms "FOA" and "SPA" are even used interchangeably, and it is often difficult to distinguish a true FOA from other kinds of disposals of participating interest used within petroleum titles. Thus, both agreements can be designed with similar terms and conditions, and whenever this paper refers to FOA, SPA, farmor/seller or farmee/buyer/purchaser, they should have the same meaning. Thus, as little publicly available material exists in relation to conditions precedent in FOAs, this paper draws from writings relating to M&A transactions in general.

a share of certain costs relating to drilling and testing on the property."[1] In other words, a farmee, who performs the obligations and other conditions set out in the FOA, is entitled to the assignment specified in the FOA. Such an assignment may be the entire leasehold owned by the farmor or some portion of it, an undivided interest in the lease, a specific amount of the land covered by the lease, or a specific depth or formation (if applicable).[2]

The best way to understand an FOA is through a hypothetical example:[3] Party A owns rights or interests in an oil leasehold or acreage. It then assigns a part, or all, of these rights or interests in the acreage to Party B. In exchange, Party B agrees to carry out some drilling work and/or pay a certain sum of money. Under the FOA, Party A, the farmor, farms-out its interest, whereas the farmee, Party B, is said to farm-in to the petroleum title (i.e., the host government instrument, such as a host government contract). Thus, "farmout agreement" can be used analogously with "farmin agreement."

The exact roles of the parties depend on the structure of the FOA. The farmee could agree to carry out and finance a certain amount of work that is necessary to fulfill a minimum work obligation set out by a host government contract, or it may agree to fund some part of the costs that the farmor would otherwise be liable to pay in undertaking that work. This is most likely to happen when, due to excessive costs, the farmor is not able, or is unwilling, to meet these work obligations on its own, but is still under pressure to fulfill those obligations, for instance under a petroleum title and/or joint operating agreement[4] (JOA).[5] The consideration, such as cash or a work program, which the parties agree to, forms the key component of a FOA transaction.[6]

Although each FOA is, or at least should be, revised in accordance with the parties' individual needs, the industry offers standard forms to enable the speedy and efficient conclusion of oil and gas transactions.[7]

1- Kendor Jones, *Something old, Something new: The evolving farmout agreement*, 49 Washburn LJ 477, 477–478 (2009), referring to Earl Brown, *Assignments of interests in oil and gas leases: Farmout agreements, bottom whole letters, reservations of overrides and oil payments*, 5 Inst. on Oil & Gas L. & Tax'n, 25, 69–70 (1954).

2- The "farmor," or "farmutor," refers to the entity that is the leaseholder or owns the drilling rights and is synonymous with the seller. The "farmee," or "farmoutee," designates the entity that buys into the leasehold interest and is given drilling rights, and is synonymous with the buyer. See Peter Roberts, *Contracts for sale, exchange or economic transfer of interests* in Eduardo Pereira (ed), *Encyclopaedia of Oil and Gas Law: Upstream* (Globe Law and Business, 2014), Volume 1, 307. See also J. Derrick, *Farmouts*, in Geoffrey Picton-Turbervill (eds), *Oil and Gas*: *A Practical Handbook*, 303, 256 (Globe Law and Business, 2nd ed., 2014) (of excerpt).

3- J. Derrick, *Farm-outs*, in Geoffrey Picton-Turbervill (eds), *Oil and Gas*: *A Practical Handbook*, 303, 251 (Globe Law and Business, 2nd ed., 2014) (of excerpt). See also Kendor Jones, *Something old, something new: The evolving farmout agreement*, 49 Washburn LJ 477, 478 (2009).

4- A JOA regulates the rights and duties of the parties in a joint venture that aims to search for and exploit oil and gas. A JOA may oblige the farmor to perform a work program, regardless of whether the farmor is able to fund it or not.

5- J. Derrick, *Farmouts*, in Geoffrey Picton-Turbervill (eds), *Oil and Gas*: *A Practical Handbook*, 303, 252–253 (Globe Law and Business, 2nd ed., 2014) (of excerpt).

6- Kendor Jones, *Something old, Something new: The evolving farmout agreement*, 49 Washburn LJ 477, 481–482 (2009).

7- For instance, the Association of International Petroleum Negotiators ("AIPN") proposes and drafts petroleum agreements that could be used in any region of the world to assist professionals in oil and gas negotiations. Their 2004 International Model Farmout Agreement is currently under revision. An unofficial 2018 advanced draft ("AIPN 2018 Draft Model FOA") has been circulated to its members. Although the draft has yet to be formally approved, its approval is forthcoming at the time of writing. The AIPN 2018 Draft Model FOA promotes flexibility and can, thus, be adapted for different regions by selecting options and alternatives that suit the needs of that particular area. See https://www.aipn.org/model-contracts/ (last accessed April 30, 2017). Other more regionally specific models include model contracts, including from the Canadian Association of Petroleum Landmen ("CAPL"), represent all parties engaged in the Canadian oil and gas industry, at http://landman.ca/about-capl/ (last accessed April 30, 2017). Similarly, forms published by Oil and Gas United Kingdom ("OGUK") aim to represent all parties involved in the offshore industry from the United Kingdom, while resolving various issues that have become more relevant to the oil and gas industry in recent years (e.g., decommissioning activities). See e.g. Agreement for the Sale and Purchase of Assets ("OGUK Model SPA") at /http://oilandgasuk.co.uk/wp-content/uploads/201505//REF09B.pdf (last accessed April 30, 2017). Finally, the Norwegian Oil and Gas Association ("NOROG"), an organization acting as a professional body and employers association for oil and supplier companies engaged in the field of exploration and production of oil and gas on the Norwegian Continental Shelf, offers its model SPA that was recently revised in 2015, at https://www.norskoljeoggass.no/en/.

Indeed, although the oil and gas industry is a global industry with operations worldwide in very different regions, each with specific needs, oil and gas projects have many similarities. Major companies communicate, work, and trade together, and they have assets all over the world. This means that the knowledge and experience gained in one region benefits all others when shared.[1]

Accordingly, although the majority of the oil and gas regions have a particular FOA model form that focuses on their specific needs, all FOAs are, however, generally based on the following provisions:

(a) Assigned interest

(b) Consideration

(c) Condition precedent

(d) Interim period

(e) Warranties and representation

(f) Default

(g) Confidentiality

(h) Termination

(i) Governing law

(j) Dispute resolution.

This paper will focus on the condition precedent and analyze it in the following sections: (iv) the rationale behind conditions precedent, (v) conditions precedent in FOAs, (vi) termination of a FOA following non-fulfillment of a condition precedent, (vii) remedies available following the termination of a FOA, (viii) resolving disputes in relation to conditions precedent in FOAs, (ix) conclusion.

II. The Rationale behind Conditions Precedent

When entering into a FOA, parties generally understand that the desirability and feasibility of the ultimate project hinges on factors that may be unknown or uncertain to them at the time of signing. In the early stages of FOA negotiation, the farmor tends to possess more knowledge about existing legal or technical factors that may affect the project. However, the farmor may be uncertain about the farmee's actual ability or reliability to carry out the project.[2] In contrast, the farmee might possess the required expertise and/or capital to develop the given project. However, as the transaction develops, the parties may discover formerly unknown legal or technical characteristics that make the project less financially viable or riskier than originally thought. For example, the parties may discover that certain required government approvals will not be granted, rendering the project impossible. This is why oil and gas transactions involve sophisticated players who should be able to deal and mitigate such risks.

So "conditions precedent" refers to events or circumstances that must exist in order for a transaction to trigger specified performances or obligations among parties. Conditions precedent are a common contracting technique used toward striking a successful balance between the parties' uncertainty about specified conditions and the parties' desire to secure commitment to the project. In other words, conditions precedent are the "events or conditions that must occur or be waived by the

1- On the oil and gas industry, see Eduardo Pereira, *Joint Operating Agreements: Risk Control for Non-Operator* (Globe Business, 2013).

2- John S. Lowe, *Analyzing oil and gas farmout agreements*, 41 Sw. L. J. 759, 796 (1987).

relevant party or parties before completion [of the transaction] can occur."[1] Effective conditions precedent allow the parties to proceed with the agreement, while offering the option to walk away from the transaction, should presently unknown or known obstacles eventually hinder the anticipated operation of the FOA.

Generally, a deal will not close absent the fulfillment of all conditions precedent.[2] However, the party for whose benefit the condition precedent is agreed upon may waive the fulfillment of such a condition or occurrence of such an event. For instance, a party may choose to waive a condition precedent that operates toward its advantage in order to avoid the termination of the said FOA. The waiving party may opt to waive the condition in instances in which it makes financial sense to proceed with the performance of the contract, unless, of course, the performance of the FOA is rendered legally impossible without the fulfillment of the condition in question.[3] Below, we address examples of conditions precedent typically incorporated into FOAs.

III. Conditions Precedent in FOAs

A. Examples of Typical Conditions Precedent

1. Consents and Approvals as Conditions Precedent

In general, a "consent provision" is any provision according to which an interest may not be transferred to the potential farmee without the consent of a specified third party or parties. Some consent provisions will set requirements to the third party's right to withhold its approval, for instance by providing that the consent of third parties can only be withheld on the basis of the farmee's lack of financial or technical capacity to perform its duties under the FOA. Other consent provisions can give third parties an absolute right to refuse consent without giving reasons for their refusal.[4]

In practice, the withholding of the approval may be due to, for instance, a simple dissatisfaction as to the financial terms of the FOA or it may result from tactical considerations, with the aim of obtaining something in return of the approval.[5] Several problems may arise if the party whose consent is required decides to withhold its approval, in particular if the very performance of the FOA is dependent on the consent. Such problems include, at the very least, a possibly significant delay between the signing and the closing of the project, and in some situations the whole project may be jeopardized. Below we will address a few conditions precedent typically added to FOAs and the fulfillment of which require the parties to obtain certain consents or approvals.

1- Section 1.1 of the AIPN 2018 Draft Model FOA at https://www.aipn.org/model-contracts/ (last accessed June 19, 2018).

2- John S. Lowe, *Analyzing oil and gas farmout agreements*, 41 Sw. L. J. 759, 796 (1987).

3- Section 5.1 of the AIPN 2018 Draft Model FOA.

4- Robert Patterson, *Acquisitions and disposals on the U.K. continental shelf: An introduction*, 11 International Energy & Taxation Review 248, 250 (2001).

5- For instance, in *Cedyco Corp v. PetroQuest Energy LLC* it was a case of the respondent's right to decline to accept a conditional consent from the original lease holder of two oil wells, which conditional consent would have obliged the respondent, the holder of the working interests to these oil wells, to indemnify the original lease holder against any liabilities arising from the operations of the claimant, to whom the respondent had offered to assign its working interests. After finding out that the claimant had a "record of violating state regulations imposed on oil and gas producers," the respondent refused to accept the original lease holder's consent, which acted as a condition precedent to the assignment of the working interests. As a result, the Fifth Circuit Court of Appeals found that "the condition precedent was never satisfied" and "[a]s a result, [the Respondent's] obligation to perform under the contract never came due"; *Cedyco Corp v. PetroQuest Energy LLC*, 497 F3d 485, (5th Cir. 2007).

a) Government Approvals

As states generally own their oil and gas resources, host governments must usually grant and assign petroleum rights and obligations through a legal framework determined and set up by the state. Typically, international oil companies, domestic oil companies, a national oil company, or a consortium of these companies become the title holder of the petroleum rights. Thus, in a majority of jurisdictions, the consent of the relevant governmental authority is required before an effective legal transfer of an interest in a petroleum title can take place.[1] Governmental or other authority (e.g., approval from merger control authorities) may also be required by the applicable law.[2]

It is, therefore, no wonder that the obtainment of government authorization is one of the most frequently used conditions precedent, and an important consideration when drafting a FOA.[3] By way of example, the AIPN 2018 Draft Model FOA,[4] section 2.3.2(a), references "obtaining the Approval of the Government. . . [as required under Article __ of the Contract]"[5] as a preeminent example of possible conditions precedent. Similarly, the OGUK Model SPA agreement[6] states that the consent of the Secretary of State is needed for the seller to legally assign the transferred rights.[7]

Although the approval may be given, for instance, in the form of a simple one-page letter from a government minister approving the project, practices vary among countries. In some jurisdictions, approval may be given by default in instances in which the government fails to respond to the request of consent within a certain period of time. In particular when the form of the authorization is very complex or the authorization is required from many sources, the parties may face difficulties securing government authorization at the outset of the project.[8] A clever precautionary approach is being used in the United Kingdom, in which the Department of Energy and Climate Change usually confirms—provided that it has sufficient information about the operation—upon the signing of the FOA that it has no objection in principle to the proposed transfer.[9] Although such a confirmation is not binding on the department, the knowledge that there are no objections in principle to the future execution of the FOA does provide comfort to the parties.[10]

1- J. Derrick, *Farm-outs*, in Geoffrey Picton-Turbervill (eds), *Oil and Gas*: *A Practical Handbook*, 303, 254–255 (Globe Law and Business, 2nd ed., 2014) (of excerpt). It can also be questioned whether the FOA should be signed prior to host government consents in cases where the wording of the condition precedent provides that the form of the purchase agreement must be approved by the party in question before it is signed; R. Major, *A practical look at pre-emptions in upstream oil and gas contracts*, 5 I.E.L.T.R., 117, 119–120 (2005).

2- Georg von Segesser, *Arbitrating pre-closing disputes in merger and acquisition transactions*, in *Arbitration of Merger and Acquisition Disputes*, ASA Special Series No. 24, 17, 26 (2005).

3- Section 2.3.2(a) of the AIPN 2018 Draft Model FOA, Section 2.2.5 of the OGUK Model SPA, Section 6.1 of the NOROG Model SPA, etc.

4- See note 9 above.

5- Section 2.3.2(a) of the AIPN 2018 Draft Model FOA.

6- See note 9 above.

7- Section 2.2.5 of the OGUK Model SPA at /http://oilandgasuk.co.uk/wp-content/uploads/2015/05/REF09B.pdf (last accessed April 30, 2017).

8- Philip Weems, *Overview of issues common to structuring, negotiating and documenting LNG projects* 8 I.E.L.T.R., 189, 199–200 (2000).

9- However, the department does not issue a binding undertaking, and thus, the formal consent procedure will need to be followed by the parties at the applicable time.

10- J. Derrick, *Farmouts*, in Geoffrey Picton-Turbervill (eds), *Oil and Gas*: *A Practical Handbook*, 303, 255 (Globe Law and Business, 2nd ed., 2014) (of excerpt).

b) Internal Approvals

Another commonly used condition precedent in FOAs is one requiring that internal approval of the farmor's or farmee's board of directors, or other relevant internal company consents, be obtained. The NOROG Model Agreement for sale and purchase of participating interests in licenses on the Norwegian continental shelf ("NOROG Model SPA") is one of the few industry models that have made attempts to tackle the issue of internal corporate approvals through an optional clause set out in the model contract. The model's section 6.1(e) reads as follows: "[c]ompletion of this Agreement is subject to and conditional upon the fulfilment of the conditions set forth below: (…) necessary internal corporate approval of the parties."[1]

An internal approval is usually given following a duly conducted due diligence, normally understood as the buyer's or the farmee's examination of the seller's or farmor's records and properties. The completion of an adequate due diligence can constitute a condition precedent of its own.[2] Through such a due diligence, the farmee should be able to reasonably assess any potential transfers of liabilities by looking at the financial, legal, tax, technical and commercial position of the target company or asset. In many cases, there will be a specific date by which the farmee must complete its examination of the farmor's records and of any other applicable public records and the farmee must submit any written objections that it may have in relation to the farmor's title. In some cases, the farmor might also conduct its own due diligence of the farmee's capabilities.

In addition, such internal corporate approvals may prove to be critical, in particular in large companies in which, because of the size of the company, the board is less likely to be aware of the details concerning the company's contract negotiations.

2. Other Typical Conditions Precedent

a) No Material Adverse Changes Clause

Parties to a FOA frequently include a "No Material Adverse Changes" clause ("MAC clause" or "MAE clause"). A MAC clause addresses the possibility that a material adverse change in circumstances, which would cause significantly harmful consequences on the target company or asset, occurs between the signing and the closing of the FOA.[3] In the event that such a change occurs, a party may refuse to perform the closing and rescind the agreement. In essence, the clause functions similarly to a *force majeure* or frustration clause by allocating the risk for events beyond the parties' control.[4]

A MAC clause is generally limited in scope, further delineating the allocation of risk between the parties. MAC clauses usually exclude changes caused by economic conditions affecting the general economy, as well as changes in legal regulations that do not target the project or affect it disproportionately.[5] Parties may impose further restrictions on the scope of a MAC clause by specifying the conditions that would trigger the MAC clause. For instance,

1- Section 6.1 of the NOROG Model SPA at https://www.norskoljeoggass.no/en/ (last accessed April 30, 2017).

2- Martin Abbott, *Fundamental issues and practical requirements affecting the purchase and sale of producing resource properties*, 29 Alta. L. Rev. 85, 97-98 (1991).

3- Robert Miller, *Canceling the deal: Two models of material adverse change clauses in business combination agreements* 31 Cardozo L. Rev. 99, 105 (2009).

4- Andrew Schwartz, *A "standard clause analysis" of the frustration doctrine and the material adverse change* clause, 57 UCLA L. Rev. 789, 811 (2010).

5- Robert Miller, *Canceling the deal: Two models of material adverse change clauses in business combination agreements* 31 Cardozo L. Rev. 99, 105 (2009).

the parties may agree that the clause will only come into effect if the price of oil reaches above or below a certain level, to avoid the clause being used by either of the parties in relation to general price fluctuations between the date of signing and completion. Indeed, quantifying the threshold at which the MAC is triggered provides clarity to the transaction and reduces the potential for dispute.[1] Finally, the MAC clause may contain wording to limit its scope when otherwise triggering conditions are created by a lack of good faith behavior from either party.

b) Compliance with Representations and Warranties

A FOA may also typically include a statement by all parties, that, as a condition precedent, all information provided under representations and warranties must be true and accurate in all material respects at closing.[2] The aim of the condition is to secure the truthfulness of the representations and warranties, which contain the farmor's and the farmee's promises toward each other.

c) The Non-Exercise of Preferential Rights

If an existing JOA is in place, the waiver or non-exercise by the other JOA parties' preemption or other such preferential rights is usually added as a condition precedent to the FOA.[3] In essence, such conditions refer to the right of an existing co-venturer to acquire the sale of any other co-venturer's rights in the joint venture before a third party. For example, section 2.2.2 of the Model OGUK SPA "requires receipt by the [farmor] of a waiver in writing by the Co-Venturers of their rights pursuant to the provisions of Clause […] of the Operating Agreement or satisfaction of such provisions without any Co-Venturer attempting to acquire the Asset in accordance with such provisions."[4]

From a farmee's perspective, as the deal cannot be completed until such conditions are waived, the addition of such waivers as conditions precedent may increase the likelihood of the deal not going through. For this reason, to secure the deal, it is preferable for the farmee to take note of such preferential rights well in advance and when possible, seek the waiver of such rights prior to the signing of the FOA. [5]

d) Other Requirements

Depending on the location and nature of the project, a variety of issues may arise, issues that need to be addressed in the conditions precedent of the FOA.[6] For instance, if there is no existing JOA in place, the parties may include the negotiation of a JOA as a condition

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1- In the absence of such a threshold, some courts have looked to the dictionary definition of "material" in their consideration of whether a circumstance qualifies as such. For instance, in *Wolf Hollow I, L.P. v. El Paso Mktg.*, the court's decision as to whether a change was "material" hinged on a simple, broad inquiry as to whether the change was "having real or important consequences." *Wolf Hollow I, L.P. v. El Paso Mktg.*, L.P., 472 S.W.3d 325, 336 (Tex. App. 2015).

2- Ibid., 12.

3- These rights can be called by one of a variety of synonymous terms: "right of first refusal," "option of first refusal," "preemptive right," "preemptive option," "first option," and "conditional or contingent right." On preferential rights, see also Edward Poitevent II & Christopher Hewitt, Preferential rights, rights of first refusal and options: The whys and wherefores (American Association of Petroleum Landmen, New Orleans, Louisiana, 2000); R. Major, *A practical look at preemptions in upstream oil and gas contracts* 5 I.E.L.T.R., 117 (2005).

4- Section 2.2.2 of the Model OGUK SPA at /http://oilandgasuk.co.uk/wp-content/uploads/2015/05/REF09B.pdf (last accessed April 30, 2017).

5- See also Section 2.3.2 of the AIPN 2018 Draft Model FOA and Section 6.1 of the NOROG Model SPA.

6- Philip Weems, *Overview of issues common to structuring, negotiating and documenting LNG projects*, 8 I.E.L.T.R., 189, 198–199 (2000).

precedent to the transfer of interest under the FOA. The parties may also wish to add a set of agreed principles to the FOA as a base for the JOA negotiations or even for the entire JOA itself.

Regarding local issues that may arise in connection with the project, the local authorities or even the farmee may require the parties to complete environmental assessments, the completion of which may constitute a condition precedent under the FOA.[1] The farmee can also be obliged by the farmor to prove its technical capacity in relation to the obligations set out in the FOA or its ability to raise the required financing for the acquisition.[2]

B. The Fulfillment of a Condition Precedent

The question as to whether a condition precedent has been fulfilled often turns, as a practical matter, upon whether the party for whose favor the provision has been drafted finds the condition to be satisfied, or, if such provision was drafted in a neutral format pending third parties' approval, how straightforward it might be to confirm such satisfaction or not. Usually, most condition precedents should be straightforward and easy to be confirmed, such as governmental approval or waiver of preemption rights. However, certain conditions (e.g., internal approval) might create more uncertainty as the party for whose advantage the provision has been drafted enjoys discretion as to whether the party is satisfied regarding the condition's fulfillment. Of course, this dynamic leaves the performing party or the party carrying the burden of fulfillment with limited options to contest the finding of fulfillment to the extent the condition was drafted in such way.

Although some conditions precedent might be fairly straightforward to confirm, such as the host governmental approval or waiver of a preemption right, as it will be granted or not, it might not be easily determined if the FOA requires that the party in charge of fulfilling the condition precedent to exert a certain level of effort in doing so or actions they should abstain to do.[3] For example, the AIPN 2018 Draft Model FOA states:

"Each Party shall [use its best endeavours] / [all reasonable endeavours] / [use its reasonable endeavours]:at its expense to satisfy the Conditions Precedent that it is to satisfy; and at the request and expense of the requesting Party, to assist it to satisfy the Conditions Precedent that the requesting Party is to satisfy."[4] Other provisions merely require that the party fulfilling the condition act *bona fide*."[5]

It is rare that the provisions setting a certain level of care describe in detail what specific actions a party must take in order to be considered to have used its "reasonable endeavors," "best endeavors," or to have acted *bona fide* in fulfilling the condition precedent. It will therefore be up to the judge, arbitrator, or other decision maker to analyze, on a case by case basis, what is expected from a party under such requirements. In the absence of specific wording that would specify the level of effort required to fulfill a condition precedent (e.g., "best endeavors" or "all reasonable endeavors"), the question of whether such obligations still exist may arise. Under

1- See e.g. Section 3.1(d) (Optional Provision) of the AIPN 2014 Model FOA.

2- Robert Patterson, *Acquisitions and disposals on the U.K. continental shelf: An introduction*, 11 International Energy & Taxation Review 248, 253 (2001).

3- For instance, one common source of dispute involves the timing of performances, such as how parties count days or in relation to the perceived effective date of a contract. See John S. Lowe, *Analyzing oil and gas farmout agreements*, 41 Sw. L. J. 759, 805 (1987).

4- Sections 2.3.3 (a)-(b) of the 2018 AIPN Draft Model Farmout Agreement.

5- A typical clause provides that "the parties shall proceed diligently, honestly and in good faith and use all reasonable efforts to fulfill the conditions precedent and shall cooperate with each other in their fulfillment"; Martin Abbott, *Fundamental issues and practical requirements affecting the purchase and sale of producing resource properties*, 29 Alta. L. Rev. 85, 98 (1991).

certain legislations, a duty to act *bona fide* is inherent in any contractual relationship and it need not specifically be mentioned in the agreement.[1]

Thus, although it is usually at the discretion of the party that is obligated to fulfill the condition precedent at hand to assess, in the first place, what it must do to fulfill these duties, the determination of the steps that are required under the condition precedent is a question of contractual interpretation. That interpretation is affected by not only the wording of the provision but also the governing law of the FOA.[2] Accordingly, the parties must be well aware of what "reasonable endeavors" or "best endeavors" have been interpreted to include under the applicable law.[3] This concern is particularly relevant when the parties adopt a model FOA, which typically relies on a common law approach, but decide to subject it to a governing civil law. In general, civil and common law jurisdictions tend to take different views as to what is required under the "reasonable endeavors" or "best endeavors" requirements and what the consequences for failing to fulfill such obligations are.[4]

IV. Termination of a FOA following Non-Fulfillment of the Conditions Precedent

The conclusion of an FOA is usually split into two phases: signing and closing. A deal is not finalized until the closing has taken place. As part of the completion of a FOA, the parties must typically produce evidence that all conditions precedent have been satisfied before the closing.[5] If a party is not able to fulfill all the conditions, the remedy for non-fulfillment of a condition precedent is usually the termination of the contract.[6] A FOA will include contractual termination provisions for such cases:

1- See e.g. Art. 1104 of the French Civil Code: "*Les contrats doivent être négociés, formés et exécutés de bonne foi. Cette disposition est d'ordre public.*" This provision explicitly states that it is a mandatory provision (of "*ordre public*").

2- How the parties decide on the governing law is determined by a range of factors, the most significant being the parties' knowledge, the prevalent practice, and the statutory requirements; R. Ellison & D. Waldron, *Governing law and jurisdiction clauses*, in John LaMaster & Caroline Moran (eds), *Oil and Gas Sale and Purchase Agreements: SPAs for International Oil and Gas Acquisitions and Divestitures*, 221 (Globe Law and Business, 2017).

3- See e.g. Peter Roberts, *Petroleum Contracts: English Law and Practice* (Oxford University Press, 2nd ed., 2016).

4- For instance, many civil law jurisdictions do not have a specific definition of "best efforts" or "reasonable efforts." An analogous, although not identical, concept would be that of good faith, which for its part is widespread in civil law jurisdictions. The differences between these two are, for instance, the extent to which a party must go to fulfill its obligations. Pursuant to a "best efforts" clause, a party may need to go as far as incurring a loss and yet use the best efforts possible to perform under the contract. But these precise implications might vary from each common law jurisdiction (e.g., English, New York, Texas laws, etc.). This is quite different from the good faith principle, which can vary in the precise implication in civil law jurisdictions, but in simplified terms would require the parties to use a "fair" behavior to complete the transaction. Furthermore, the requirement to act in good faith in contractual relationships typically results from civil codes in civil law jurisdictions, whereas a duty to use "best efforts" must be explicitly added to a contract for it to bind the parties under common law jurisdiction.

5- The FOA will specify a mechanism for completion (this typically takes place five or ten business days following satisfaction of the conditions precedent) and the actions that are to take place at that time. Such actions will usually include the payment of the relevant consideration, the delivery of appropriate transfer and title documents, the production of evidence that conditions precedent have been satisfied, and the delivery of appropriate corporate authorizations. See also R. Patterson, *Acquisitions and disposals on the U.K. continental shelf: an introduction*, 11 International Energy & Taxation Review 248, 253 (2001); Julien Fouret & Alexis Mourre, *Pre-closing disputes*, in Edward Poulton (ed.) *Arbitration of M&A Transactions—A Practical Global Guide* (Global Law and Business, 2013).

6- In contrast, if the provision is in nature another essential term of the contract, the non-fulfillment of it does not act as a precedent to the existence of the contract, but as a breach of the parties' contractual obligations. For instance, where the delivery of goods is subject to the opening of a credit and where the buyer fails to provide the credit, the seller may treat himself as discharged from a further performance of the contract and sue the buyer for damages for not providing the credit. However, if the delivery of goods is not subject to the opening of a credit, a failure to provide credit allows the seller to sue the buyer for damages; Kim Lewison, *The Interpretation of Contracts* (Sweet & Maxwell, 5th ed., 2011) (referring to: *Trans Trust SPRL v Danubian Trading Co Ltd*; [1952] 2 Q.B. 297).

A. Drop Dead Date

The most common cause for termination is that the closing conditions have not been met or waived by a specified date,[1] called a "long stop date" or "drop dead date," which usually takes place sometime after the initial closing date.[2] Thus, if the conditions precedent have not been fulfilled by this specific date, either party may typically terminate the agreement, regardless of any event of force majeure.[3]

B. Other Termination Rights

The parties may also decide to enable either one of them to terminate the FOA prior to the drop dead date if events take place that clearly endanger the fulfillment of a closing condition. In essence, these rights provide the parties with a way out of the agreement if it is clear that the conditions precedent will not be fulfilled by the drop dead date.[4] For instance, in case of legal impediments to the closing of the deal, such as the lack of a governmental approval required by law, the parties may state in their FOA that either party may terminate the FOA immediately if the government approval is refused. Another example of the parties' right to terminate the agreement before the drop dead date could be a requirement to renegotiate certain contractual obligations with the government, a contractor, or another third party that impact the FOA. For instance, the farmor or the farmee could require as a condition precedent to the FOA that the amount of a bank guarantee by the host government be reduced. If it becomes clear that this condition does not materialize before the drop dead date, one or both of the parties can be allowed to walk away from the deal immediately.[5] In any event, regardless of the type of termination right, any "way out condition" should be clear and narrow to avoid disagreements.

Although termination is the typical sanction following non-fulfillment of a condition precedent, it is not the only one. Other possible consequences for failure to act in accordance with a condition precedent are the finding of a material breach or the triggering of the other side's right to implement certain contractual protections and/or postpone its performance, as it will be described in the next section.

V. Remedies Available to a Party Following the Termination of a FOA

A party's termination of a FOA does not waive the remedies available to parties for termination of the same agreement. Rather, the termination ends only the parties' material obligations pursuant to the agreement. Under the terms of the agreement, the parties usually have certain obligations toward each other following the termination of the FOA. For instance, parties may remain obligated to pay termination fees and/or reimburse relevant funds following termination. The following section

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1- For instance, the OGUK Model SPA form provides that should the condition precedent not be satisfied, or be waived prior to entering into an agreement, this agreement will be terminated and will no longer have any effect; OGUK Model SPA at /http://oilandgasuk.co.uk/wp-content/uploads/2015/05/REF09B.pdf (last accessed April 30, 2017). See also Georg von Segesser, *Arbitrating pre-closing disputes in merger and acquisition transactions*, in *Arbitration of Merger and Acquisition Disputes*, ASA Special Series No. 24, 17, 25 (2005); John LaMaster & Caroline Moran (eds), *Oil and Gas Sale and Purchase Agreements: SPAs for International Oil and Gas Acquisitions and Divestitures*, 39 (Globe Law and Business, 2017).

2- Committee on Negotiated Acquisitions, *The M&A Process—A Practical Guide for the Business Lawyer*, 231 (ABA, Book publishing, 2005). See also Section 2.3.10 of the AIPN 2018 Draft Model FOA.

3- After the termination of a FOA, the parties may need to deal with numerous issues. For instance, if the farmee has expensed any sums of money before the termination took place, the FOA will usually include provisions covering the reimbursement of such funds in the case of termination.

4- Christopher Harrison, *Make the Deal: Negotiating Mergers & Acquisitions*, 149 (Bloomberg Financial, 2016).

5- See also Section 2.3.8 of the AIPN 2018 Draft Model FOA.

discusses some typical contractual remedies to which parties may be entitled following the termination of a FOA due to non-fulfillment of a condition precedent.

A. Break-up Fees

As an added safeguard against termination of the agreement between signing and closing, FOAs frequently contain provisions which impose financial "penalties" on one or more parties in the event of termination. These provisions may be referred to as "break-up fees," "deal protection fees," or "termination fees." Break-up fee provisions may be flexibly crafted for application to either a diverse or a narrow array of termination scenarios. The provision may be applicable, for instance, in all scenarios of termination or only where a party fails to perform a specific task. A typical break-up fee provision requires the farmor to compensate the farmee when previously agreed-upon circumstances prevent the closure of the deal and the farmee is forced to terminate the FOA. Although break-up fee provisions usually impose termination costs on the farmor, they may also be drafted to require payment from the farmee to the farmor in what is termed a "reverse" break-up fee provision.

The AIPN 2018 Draft Model FOA recognizes such concern as follows:

"[Drafting Note: Consider introducing a withering reassignment and/or a break fee liquidated damages/penalty if appropriate and if feasible in the applicable jurisdiction.]"[1]

Break-up fee provisions are particularly useful to both parties because they monetarily quantify the parties' exposure under the agreement. Moreover, break-up fee provisions delineate the remedies available to parties in the event of termination, eliminating the need for costly dispute resolution procedures later on even though the parties can still dispute the application to such provisions.

B. Reimbursement of Costs

In addition to allocating among parties the "penalties" for termination via break-up fee provisions, FOAs may also include provisions to ensure reimbursement of costs and/or payments in case of termination. For instance, some FOAs provide that a party who has incurred costs and/or payments in relation to the project between signing and closing is entitled to reimbursement of its costs following the termination of the FOA. Typically, such costs and expenses may include lawyers', accountants' and other third party advisors' fees, in addition to external costs expended in financing and structuring necessary operations for the project. Alternatively, the FOA may provide that each party bears the risk of any costs incurred and lost before closing. The farmee might be required to pay certain amounts in order to proceed with the said transaction (e.g., deposit, premium, etc.). This is why the AIPN 2018 Draft Model FOA refers to the farmee payments and the possibility for the farmor to retain certain payments in specific cases.[2] Of course, provisions for the reimbursement of costs and/or payments are not necessarily included in FOAs, particularly where the parties did not anticipate incurring costs and/or payments prior to closing. These costs and/or payments could be way higher if the assignment has been approved by the relevant host government but certain condition precedent were yet to be met. For this reason, formal assignment requests to the host government (if applicable) shouldn't be submitted prior to the satisfaction of other internal conditions precedent, otherwise the host government could approve an assignment pending certain conditions precedent that might not be met.

C. Indemnification Provisions

Indemnification provisions are frequently drafted into FOAs to clearly allocate risk among the

1- Section 11.5 of the AIPN 2018 Draft Model FOA.

2- Section 11.4 of the AIPN 2018 Draft Model FOA.

parties, as well as to list and limit the remedies available to the parties if termination occurs in a covered setting.[1] Usually, indemnification provisions allow the farmee to recover damages for breach or misrepresentations from the farmor, although the roles may be reversed to allocate risk to either party.[2] Specifically, indemnification provisions make the indemnitor liable for losses resulting from misrepresentation, breach of warranty, resulting litigation, or other various costs identified by the contract. Significantly, indemnification provisions do not protect the indemnitee from every harm; rather, the provision only protects the party from losses associated with the provision.[3] Provisions may specify an overall cap on the indemnitor's liability as well as minimum level of damages the indemnitee can claim under the provision. Indemnification provisions may also limit the amount of time for which the indemnitor will be liable for damages. In the absence of an indemnification provision, the governing law may provide a cause of action for the aggrieved party and may impose an alternative statute of limitations for such a claim.

D. Reassignment

Ideally, governmental approval should not occur prior to the conclusion of all conditions precedent. Such approval should be the last condition in order to give effect to the transfer. However, if all conditions precedent did not occur prior to such governmental approval and/or if the farmee defaults in accordance to the relevant FOA, then the farmor and/or farmee (as the case might be) may request the reassignment of the said transfer.

The AIPN 2018 Draft Model FOA addresses this potentially awkward situation as follows:

"If after Completion Farmee fails to remedy a Farmee Default to the [sole / reasonable] satisfaction of Farmor within [thirty (30)] Business Days from the date of Farmee's receipt of the Default Notice, then Farmor shall have the right to deliver a notice to Farmee (the "Reassignment Notice") demanding Farmee to transfer the Farmout Interests, free from all Encumbrances back to Farmor for a consideration of [insert nominal value] (the "Reassignment").[4]

The Parties should be careful with this complex situation (especially during the interim period) as the obligations between the Parties and various agreements might differ so as the risk each own might bear as well.

VI. Resolving Disputes in Relation to Conditions Precedent in FOAs

Despite the time and cost associated with dispute resolution, many FOAs lack diligent dispute resolution mechanisms. In part, this deficiency is due to the fact that parties tend to address dispute resolution planning only at the end of tedious negotiation proceedings. Generally, options for dispute resolution available to parties of a FOA include negotiation, mediation, expert determination, arbitration, or court resolution in a mutually agreed jurisdictional forum. FOAs may provide for a combination of these procedures, although the majority international FOAs tend to provide arbitration as the

1- E. Smith et al., *International Petroleum Transactions*, 671 (Rocky Mountain Mineral Law Foundation, 2014).

2- D. Butler, *Unpublished paper*, in E. Smith, et al. (eds.) *Dispute Resolution in International Petroleum Transactions*, 681 (Rocky Mountain Mineral Law Foundation, 2014).

3- Parties should carefully analyze the language of a proposed indemnification agreement to ensure that the indemnitor's liability is appropriately balanced with its capacity to efficiently protect from such loss, including a consideration of insurance. See *Rodrigue v. LeGros*, 552 So.2d 703, 705 (La. App. 1989) aff'd 563 So.2d 248 (La. 1990) (holding that an indemnification clause between parties, covering losses "occurring, growing out of, incident to, or resulting directly from the Work applied to harm which occurred to an employee on his way to the worksite."). With regard to drafting language, courts generally consider the use of words "indemnify," "defend," "release," and "hold harmless," to be determinative of the existence and scope of an indemnification provision.

4- Section 11.5 of the AIPN 2018 Draft Model FOA.

preferred means of resolution.[1] Arbitration tends to be a preferable option due to the parties' ability to select the arbitrators, and because arbitration tends to be an efficient, predictable and relatively private forum in which to resolve conflicts.[2] However, some models suggest arbitration should follow initial efforts at mediation and negotiation.[3]

Conditions precedent are a common source of disputes between parties. Disputes related to conditions precedent often arise during the period between the signing and the closing of the FOA, at the time when parties attempt to perform their obligations pursuant to the conditions ("pre-closing" disputes). Parties harmed due to the non-performance or other contractually non-compliant behaviors by another party may claim monetary damages, although some jurisdictions may order specific performance of the contract, or damages in addition to specific performance.

A. Typical Disputes Arising in Connection with Conditions Precedent

Disputes relating to the fulfillment of conditions precedent to a FOA are generally resolved in the early stages of the project, subject to closed-door negotiation and arbitration proceedings supplied by the terms of the FOA. For this reason, there is little case law or other information regarding these disputes available to the public domain. Therefore, the analysis of disputes tending to arise in the course of fulfilling conditions precedent is confined to an overview of pre-closing disputes generally.

Typically, disputes involving conditions precedent relate to whether a particular condition has occurred. Such a dispute may concern the actual conduct of the parties, or it may concern an interpretation of the contract itself to determine if a party's performance or another occurrence satisfies the terms of the agreement. Specifically, disputes frequently concerning whether a proper governmental approval has been obtained; whether a party has duly endeavored to obtain a given authorization by a third party; whether a new circumstance or occurrence qualifies as a material adverse change, thus triggering a relevant MAC clause; or whether the parties used their best or reasonable efforts to satisfy the condition precedents.[4]

Although the FOA may be equipped with robust dispute resolution procedures, disputes involving the interpretation of conditions precedent may nevertheless be appealed to tribunal proceedings. To resolve such interpretive disputes, the courts or tribunals of some jurisdictions may look to the text of the FOA in its entirety to construe the parties' intent in drafting a particular clause.[5] In other words, courts or tribunals may look to the entire agreement to determine whether the parties likely intended for the disputed occurrence, the performance to be required and to what extent the governing law principles and other rules established under the legal system might affect the said contract.

B. Negotiation and Mediation

While parties may be under obligation to negotiate in good faith throughout the completion of the FOA, the FOA itself may supply formal terms under which negotiations should take place.[6] The

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1- D. Butler, *The scope of indemnities*, in E. Smith et al. (eds.) *Dispute Resolution in International Petroleum Transactions*, 377 (Rocky Mountain Mineral Law Foundation, 2014).

2- The ICC reported that, in 2017, energy cases accounted for 19 percent of its new caseload; ICC Dispute Resolution Bulletin at https://cdn.iccwbo.org/content/uploads/sites/32017-/07/2018/icc-dispute-resolution-statistics.pdf (last accessed Aug. 20, 2018).

3- Sections 15.2–15.4 of the AIPN 2018 Draft Model.

4- Georg von Segesser, *Arbitrating pre-closing disputes in merger and acquisition transactions* (2005) in *Arbitration of Merger and Acquisition Disputes*, ASA Special Series No. 24, 17, 28.

5- See e.g. *TransTexas Gas Corp. v. Forcenergy Onshore, Inc.*, [2004] Tex. App. LEXIS 7877, [15].

6- A. Timothy Martin, *Dispute resolution in the international energy sector: An overview*, J. World Energy Law Bus. 4 (4): 332 (2011).

AIPN 2018 Draft Model FOA suggests optional negotiation and mediation procedures to precede arbitration between the parties.[1] Like arbitration, mediation offers a confidential, cost-effective and flexible approach to dispute resolution.[2] To commence the tiered resolution proceedings, the aggrieved party must first submit a "notice of dispute."[3] Usually within thirty days of receiving the notice, the parties' senior executives must hold negotiations, with or without legal counsel.[4] The parties may thereafter request mediation between them, to occur within thirty days of the negotiation between senior executives.[5] Mediation should occur under the supervision of a neutral mediator, hopefully resolving any remaining conflicts between the parties. However, the result of a mediation is generally not binding absent a signed settlement between the parties.[6] Furthermore, scholars have noted the absence of knowledgeable mediators in the oil and gas field.[7]

C. Arbitration

Although provisions for negotiation and mediation may offer meaningful venues by which parties may resolve their disputes about the meaning or performance of a condition precedent, the majority of parties to international FOAs might provide that arbitration be available to remediate possible disputes at any stage of the transaction.[8] Arbitration is a tribunal-like proceeding overseen by one or more arbitrators who render binding decisions to resolve disputes among parties.[9]

As previously discussed, arbitration boasts several advantages as a dispute resolution mechanism. Notably, arbitration offers a predictable procedure for dispute resolution, based upon the contract between the parties that may specify the location, governing body of law and procedural rules that will govern the dispute resolution process.[10] Arbitration is generally speedier than litigation in a judicial forum,[11] which may be an advantage toward resolving disputes around conditions precedent quickly such that parties are free to proceed with the project if it is still possible. As a general rule, arbitration awards may be easier to enforce across jurisdictions than judicial judgments of damages, and the decisions are not appealable absent some rare exceptions.[12] Arbitration is also a particularly attractive solution to parties of an oil and gas

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1- Sections 15.2–15.3 of the AIPN 2018 Draft Model FOA.

2- L. C. McManus, *Mediation in oil and gas law disputes*, LexisNexis Legal Newsroom (2013).

3- Section 15.1 of the AIPN 2018 Draft Model FOA.

4- Sections 15.2–15.3 of the AIPN 2018 Draft Model FOA

5- Sections 15.2–15.3 of the AIPN 2018 Draft Model FOA.

6- A. Timothy Martin, *Dispute resolution in the international energy sector: An overview*, J. World Energy Law Bus. 4 (4): 332 (2011); L. C. McManus, *Mediation in oil and gas law disputes*, LexisNexis Legal Newsroom (2013).

7- J. P. Bowman, *Dispute resolution planning and pitfalls for energy and natural resources disputes*, 50 Rocky Mt. Min. L. Inst. [8-1] (2004).

8- Section 15.4 of the AIPN 2018 Draft Model FOA. However, courts in the United States are increasingly skeptical of mandatory arbitration clauses. See *Scherk v. Alberto-Culver Co.*,

9- John Henn, *Where should you litigate your business disputes*? in American Arbitration Association (eds.), *American Arbitration Association Handbook on Arbitration Practice*, 9 (2011).

10- See Paul Oxnard & Bernard Le Bars, *Arbitration of energy disputes: Practitioners' views from London and Paris*, in Association for International Arbitration (eds.), *Alternative Dispute Resolution in the Energy Sector*, 55 (2009).

11- D. Butler, *The scope of indemnities*, in E. Smith et al. (eds.) *Dispute Resolution in International Petroleum Transactions*, 378 (Rocky Mountain Mineral Law Foundation, 2014).

12- Mark Clark & Jessica Neuberger, *Drafting effective dispute resolution clauses*, in R. King (ed.), *Dispute Resolution in the Energy Sector*, 13 (2012).

transaction because the proceedings can remain confidential, if the parties so agree.[1] Arbitration proceedings are generally private, keeping evidence and awards confidential from the public and competitors, and free from political commentary.

However, the advantages of an arbitration clause over other dispute resolution mechanisms hinges entirely on whether the clause has been carefully planned to secure the interests of fairness, neutrality and efficiency that arbitration is intended to provide. Parties to a cross-border transaction should carefully draft the various elements of their arbitration clause to effectively capture these key advantages, considering factors such as location and jurisdiction, arbitrator selection, award enforceability and finality, confidentiality of proceedings and actual efficiency of the arbitration procedures as compared to other dispute resolution pathways.

Among several factors for consideration during FOA drafting, the parties should first agree upon a location for arbitration to take place, called the "seat" of the arbitration.[2] The seat of the arbitration is an important decision because it determines the procedural law that governs the proceedings, whether courts in the jurisdiction have the right or opportunity to intervene in the proceedings, whether the parties have the right to appeal the decision, and the enforceability of any arbitration award. Moreover, some jurisdictions lack straightforward enforcement procedures or arbitration awards. England, France, Hong Kong, New York State, Sweden, and Switzerland tend to be popular arbitration seat choices, due to their reputations for housing institutions specializing in arbitration and for allowing minimal court interference in arbitration proceedings.[3] In any case, however, the parties should refrain from designating any one party's country of incorporation as the seat of arbitration to prevent disproportionate advantages to a single party.[4]

Additionally, the parties' agreement upon the number and selection of arbitrators is an equally important step in drafting a thorough and considered arbitration clause. Parties may select a number of arbitrators (usually between one and three) to preside over the proceedings. The arbitrators should possess experience in the industry and an understanding of FOAs. For instance, in a dispute involving two parties, the AIPN 2018 Draft Model FOA suggests that each party select one arbitrator who must then jointly agree upon the third arbitrator.[5] As arbitrators can be chosen for their skill, knowledge, or experience in international oil and gas transactions, the arbitrator selection process represents a major advantage of arbitration over other dispute resolution methods. In particular, arbitrators with industry experience may draw upon their own knowledge as to the normal meaning of common conditions precedent.

Although arbitration is the most common avenue for dispute resolution with regard to FOAs, it may nonetheless be as costly and time consuming as litigation, diminishing its advantages as a dispute resolution mechanism. By first clearly drafting the conditions precedent in a FOA, and

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1- Section 15.5 of the AIPN 2018 Draft Model FOA.

2- Paul Oxnard & Benoit Le Bars, *Arbitration of energy disputes: Practitioners' views from London and Paris*, in Association for International Arbitration (eds.), *Alternative Dispute Resolution in the Energy Sector*, 66 (2009).

3- As a general rule, parties should opt to seat the proceedings in a country that has ratified the New York Convention. Countries bound by the New York Convention must usually enforce awards rendered by arbitration proceedings in another contracting country. Unlike the majority of UN members who have signed the Convention, Iraq and Sierra Leone are notable non-signatories. The Convention on the Recognition and Enforcement of Foreign Arbitral Awards, Contracting states, at http://www.newyorkconvention.org/list+of+contracting+states (last accessed August 15, 2018).

4- Paul Oxnard & Benoit Le Bars, *Arbitration of energy disputes: Practitioners' views from London and Paris*, in Association for International Arbitration (eds.), *Alternative Dispute Resolution in the Energy Sector*, 57–58 (2009).

5- It is suggested that three arbitrators should be the default in international transactions; Rocky Mt. Min. L. Inst. 7-1 2002. The AIPN 2018 Draft Model FOA concurs; Section 15.4 of the AIPN 2018 Draft Model FOA.

second, by clearly drafting the parameters or triggers of an arbitration clause, arbitration can be an efficient and fair avenue to resolve disputes.

D. Expert Determination

Expert determination is a dispute resolution mechanism with particular relevance in the energy industry, as disputes within energy contexts frequently hinge upon an interpretation of industry-specific issues. Expert determination as a dispute resolution option is a creature of the contract to which parties have signed, resulting in a final and binding disposition.[1] Expert determination is available to parties only when the terms of the transaction dictate that, upon dispute, a third-party expert will render an opinion through a procedure dependent on the terms of the agreement. Generally, this means that the expert determination process is not subject to other rules of civil procedure, absent the applicability of some case law regarding expert determination procedures.[2] Courts of most jurisdictions will respect the opinion of the expert and will abstain from interference with that judgment. However, some courts do not recognize expert determination as a valid mode of dispute resolution, making such outcomes difficult—if not impossible—to enforce judicially.[3]

A primary advantage of expert determination as a dispute resolution mechanism is the industry-specific expertise of the expert himself/herself, particularly in the instance of conditions precedent for which instructive case law is sparse. For example, expert determination is commonly used to resolve questions as to whether production in a certain field is still viable economically, or to address issues of pricing, facility construction, or contract terms.[4] Moreover, expert determination tends to be streamlined, cost-effective, and confidential. With regard to the importance of confidentiality, the 2018 AIPN Draft Model International FOA proposes the following optional provision, with equal applicability to previously discussed resolution mechanisms such as negotiations, mediations and arbitration:

"All negotiations, mediation, arbitration, and expert determinations relating to a Dispute (including a settlement resulting from negotiation or mediation, an arbitral award, documents exchanged or produced during a mediation or arbitration proceeding and memorials, briefs or other documents prepared for the arbitration) are confidential and may not be disclosed by the Parties, their employees, officers, directors, counsel, consultants and expert witnesses, except (under Article **Error! Reference source not found.**) to the extent necessary to enforce this or any arbitration award, to enforce other rights of a Party, or as required by law; provided, however, that breach of this confidentiality provision shall not void any settlement, expert determination or award."[5]

E. Judicial Remedies

Despite their best efforts to plan for alternative means of remediation, parties may nonetheless find themselves in judicial litigation. For instance, judicial litigation may occur in the aftermath of arbitration in order to seek injunctions or enforcement of arbitral awards. For this reason, parties planning for arbitration should still consider the possibility of judicial involvement. To ensure that judicial resolution is seamless and fair, parties should plan the judicial setting accordingly.

1- Clive Freedman & James Farrell, *Energy and natural resources*, in *Expert Determination*, 4.8 (5th ed., 2014).

2- See J. Farrell, *Expert determination*, in R. King (ed.), *Dispute Resolution in the Energy Sector*, 39 (2012).

3- China, for instance, is one such jurisdiction that has historically not enforced expert determination findings. See J. Farrell, *Expert determination*, in R. King (ed.), *Dispute Resolution in the Energy Sector*, 40 (2012).

4- C. Freedman & J. Farrell, *Energy and natural resources*, in *Expert Determination*, 4.8 (5th ed., 2014)

5- Section 15.5 of the AIPN 2018 Draft Model FOA.

Judicial litigation must occur in some jurisdiction, the location of which is a complicated decision in transactions involving multiple parties, perhaps in addition to the farmor and the farmee. Parties may agree to a jurisdiction in advance per the terms of the FOA. The parties may advocate for a forum with laws advantageous to the plaintiff and disadvantageous to the defendant, or vice versa. Such "forum shopping" may result in an adversarial dynamic among parties, even before the project begins. However, as a matter of practice, some jurisdictions are more likely than others to enforce arbitral awards rendered in other countries, including countries that are signatories to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention").[1]

Additionally, in the absence of an arbitration clause or other dispute resolution mechanism in the FOA, parties may seek to resolve their dispute in a judicial forum by filing a complaint. As discussed in the prior section, arbitration is usually the preferred option for resolving disputes generally, as well as in the context of a FOA. While judicial resolution of claims has not historically offered advantages such as speed, cost-effectiveness, neutral decision-makers, or enforceability of judgments, judicial litigation may sometimes be an appropriate option for parties to a FOA. For instance, judicial litigation may be preferable where parties are not willing to risk having a final arbitration award rendered against them, without the opportunity to appeal or challenge the arbitrator's judgment or to create a legal precedent.[2]

Conclusion

In sum, conditions precedent offer the parties a FOA flexibility to commit to a deal before obtaining the necessary approvals or fulfilling other required conditions. As a matter of practice, parties should always strive to fulfill each and every condition precedent as early on in the project as possible to ensure performance and execution of the transaction and to protect any existing or planned investments in the deal.

Quick performance of conditions precedent is, of course, a fruitless goal, absent clear expectations of performance and standards for fulfillment. While conditions precedent help secure the parties' interests, allowing them to commit to a deal before certain conditions are met, poorly drafted conditions precedent may compromise the interests of the parties and the fulfillment of the ultimate project. Conditions precedent may be subject to differing interpretations, leading to disputes among the parties about whether a particular condition has or has not been fulfilled. At a minimum, FOAs must be revised to accommodate the contract's governing law. Because the possibility of dispute may convolute the completion of the project, parties should endeavor to construct FOAs with clear terms and definitions to avoid ambiguity and to fulfill the conditions precedent as early on in the process as possible to ensure that neither party can use deliberate non-performance to kill the project in its advanced stages. However, as such disputes inevitably arise, the parties should reinforce FOAs with efficient alternative dispute resolution processes.

1- UNCITRAL, Convention on the Recognition and Enforcement of Arbitral Awards: 1958 New York Convention Guide, at www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention.html (last accessed September 24, 2018). Signatory states include England, Hong Kong, Sweden, and Switzerland, among many others.

2- D. Butler, *The scope of indemnities*, in E. Smith et al. (eds.) *Dispute Resolution in International Petroleum Transactions*, 378 (Rocky Mountain Mineral Law Foundation, 2014).

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