Production and offtake rights in joint operating agreements: lessons from Pohokura†

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In March of 2015 New Zealand's Court of Appeal brought to a conclusion a long running dispute between the joint venture partners in the Pohokura gas and condensate field located in Taranaki, New Zealand. Todd Pohokura v. Shell Exploration NZ Limited et ano deals with the rights to production and offtake arising under the Association of International Petroleum Negotiator's (AIPN) 1995 Model Form joint operating agreement (JOA), the powers of the Operating Committee in regards thereto and the practical implications of entering into a field development without documenting all the necessary gas sale and transportation arrangements in advance.

The factual matrix provides an opportunity to review the principles of common law relevant to production and offtake, including the development of those principles from early English common law into U.S. domestic law, and how those principles have been reflected in model form JOAs on both sides of the Atlantic, including the AIPN forms and ultimately the Pohokura JOA.

The analysis confirms the New Zealand courts' rulings upholding the power of the Operating Committee to determine production rates under the AIPN Model form. However, it concludes that gas offtake arrangements that amend or add to the rights and obligations of the parties under the JOA must be agreed unanimously and are not within the jurisdiction of the Operating Committee to determine.

Occasionally, joint ventures are orally agreed upon and joint expenditures commenced before the joint operating agreement is finalized. Once operations commence without a contract in place, the business pressure to negotiate and execute the contract seems to diminish. Although this seems counterintuitive, this situation happens frequently. This is not a problem until the parties have a dispute. They then find that

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† The factual background and references to clauses are sourced from publicly available information. In particular the High Court judgment runs to 173 pages and sets out in detail the relationship of the parties, the factual matrix and key terms of the Pohokura JOA.

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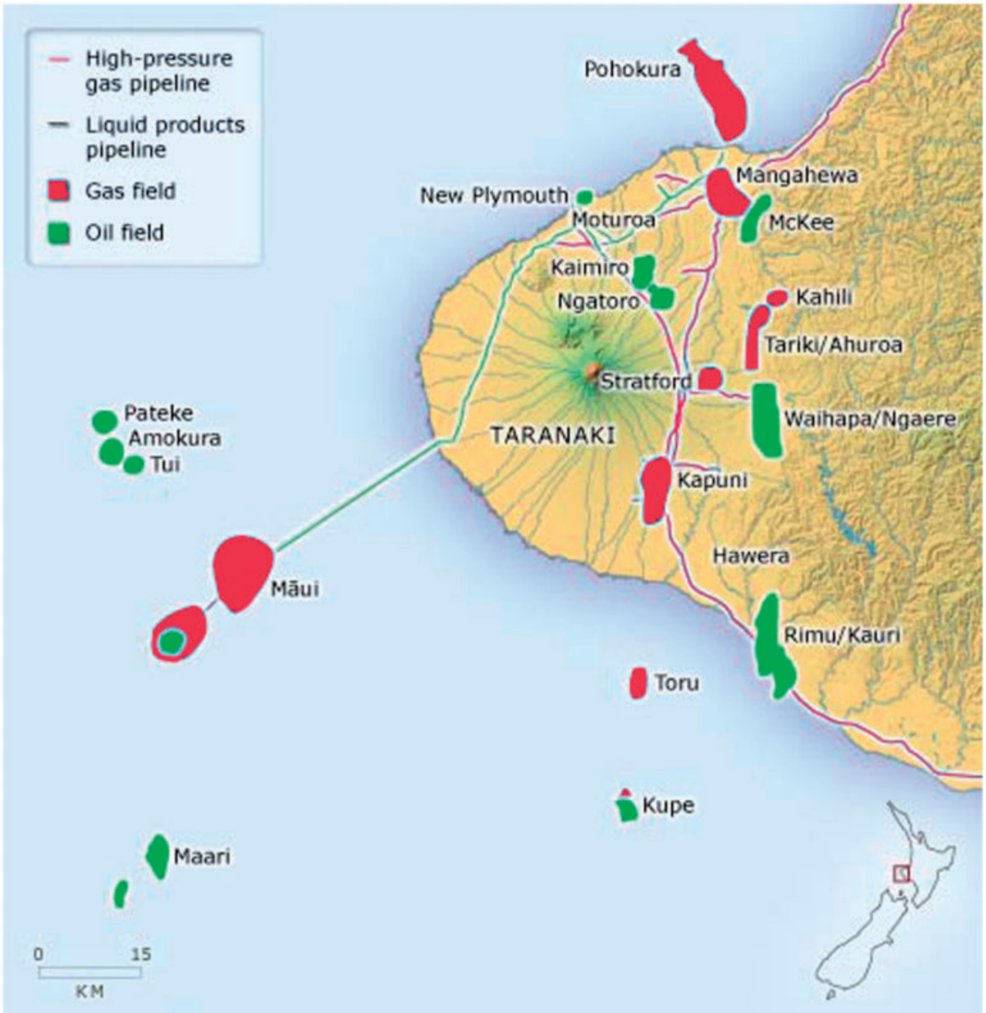

Map of gas and oil fields and infrastructure, Taranaki, New Zealand.

they either do not know what they agreed upon or they argue vociferously for their version of what they thought they agreed upon.

—Tim Martin and Jay Park, 2010[1]

In March of 2015, New Zealand's Court of Appeal brought to a conclusion a long-running dispute between the joint venture partners in the Pohokura gas and condensate field located in Taranaki, New Zealand. *Todd Pohokura v Shell Exploration NZ Limited et*

1 T Martin and J Park, 'Global Petroleum Model Contracts Revisited - Higher, Faster, Stronger' (2010) 3(1) JWELB 9.

ano[2] deals with the rights to production and offtake arising under the Association of International Petroleum Negotiator's (AIPN) 1995 Model Form joint operating agreement (JOA), the powers of the Operating Committee in regards thereto and the practical implications of entering into a field development without documenting all the necessary gas sale and transportation arrangements in advance.

1. The New Zealand petroleum framework and industry

Legal system

New Zealand is a British Commonwealth country whose system of law and government is based squarely on British democratic principles and English common law. Until 2003, the highest court of New Zealand was the British Privy Council and decisions of England's House of Lords remain highly persuasive for New Zealand's judiciary.

The primary legislation governing petroleum is the Crown Minerals Act 1991 (CMA). It provides for a petroleum regime where, similar to the UK, petroleum *in situ* is vested in the Crown.[3] International oil companies, the IOCs, are able to obtain exclusive rights for exploration pursuant to an exploration permit and, in the event of a discovery, obtain a mining permit permitting extraction activities once a field development plan (FDP) has been approved. Title to production transfers from the Crown when it is 'lawfully obtained' by the permit holder.[4] The Act recognizes that the 'permit holder' may be constituted by several 'permit participants'. It will be their JOA that will determine how production is divided.

New Zealand petroleum industry

The industry has a long history in New Zealand with oil being first dug out of Taranaki beaches in 1867. But it was not until the Shell–Todd joint venture discovered the Kapuni field that commercial gas began flowing. Todd Petroleum Mining Company Limited was and remains wholly owned by the Todd family. The family is one of New Zealand's most successful commercial organizations with interests in property, health care, mining, wine and, relevantly, a wholesale/retail gas and electricity distribution business called 'Nova Energy'. Their joint venture with Shell commenced in 1955[5] with Kapuni being discovered in 1959 and with first gas flowing in 1969.

The joint venture discovered the Maui gas and condensate field, located offshore of Taranaki, in 1969. At that time, it was one of the largest gas fields in the world. The Government, through a state-owned subsidiary, the Petroleum Corporation of New Zealand Limited (Petrocorp), took a 50 per cent participating interest share. Another state-owned entity, Natural Gas Corp agreed to buy the gas from the Maui owners under

2 CA508/2010 [2015] NZCA 71 (Court of Appeal), <https://forms.justice.govt.nz/search/Documents/pdf/jdo/6d/alfresco/service/api/node/content/workspace/SpacesStore/579f9a7c-beee-42ed-ac64-491e67d6ed91/579f9a7c-beee-42ed-ac64-491e67d6ed91.pdf> accessed 12 August 2015

3 See s 10 Crown Minerals Act 1991.

4 See s 31 Crown Minerals Act 1991.

5 See Shell Todd Oil Services Limited: *Our Proud History*. <http://www.stos.co.nz/our_proud_history.asp> accessed 12 August 2015

a joint sale, life of field take or pay gas sales contract. A 307 km, 34–36 inch, pipeline from Taranaki, where Maui gas is landed, to Huntly, just south of Auckland was constructed that links into the wider North Island gas transmission network developed on the back of the Kapuni field development.

Government policy in the early 1980s was to have Petrocorp participate in new exploration activity with entitlements ranging from 25.5 per cent to 51 per cent (the exact amount being publicized prior to the licensing round) and this practice continued in subsequent licensing rounds. Because of Petrocorp's involvement in such a large number of licences, it was deemed desirable to develop a standard form JOA. Because of the similarity of British and New Zealand law, Petrocorp adopted the model form JOA developed by the British National Oil Company (BNOC) as the basis for its 1981 and subsequent joint ventures.[6]

Petrocorp was publicly listed in 1987 and eventually bought out by Fletcher Energy, which in turn was acquired by Shell in 2000. Subsidiaries of Shell, Todd and now OMV own the Maui field respectively in 83.75 per cent, 6.25 per cent and 10 per cent proportionate shares. Maui continues to be a major gas and liquids producer.

New Zealand's total current annual gas production is ~200 petajoules (~190,000 MMCF) per year which is delivered to a mix of large industrial users, power generators and to the domestic retail market. Significant quantities are exported as methanol in volumes that have fluctuated as plant has been put into or out of mothballs depending on gas supply. Methanol production currently accounts for some 40 per cent of all New Zealand gas production.

2. Factual background to Pohokura

The Pohokura field was discovered in 2000 and contains a mix of gas and condensate. The field development was sanctioned in 2004. The owners and their proportionate ownership interests were as follows: Shell Exploration NZ Limited (Shell) 48 per cent (the Operator); OMV New Zealand Limited 26 per cent (OMV); and Todd Pohokura Limited 26 per cent (Todd). They agreed to dispose of gas jointly and share condensate arising proportionately to their ownership interests. Their JOA was based on the AIPN's 1995 Model Form. Under Article 9.1 of that form (Article 10.1 of the Pohokura JOA) each Party is to separately take and dispose of their production in quantities determined by the offtake agreement agreed under Article 9.2 (Article 10.2 of the Pohokura JOA) and subject to any 'special arrangements' for gas disposition that might be entered into under Article 9.3 (Article 10.3 of the Pohokura JOA). Accordingly, the JOA was amended to make clear that joint sales could be a 'special arrangement' for gas disposal, on terms to be agreed. An FDP was submitted envisaging the construction of plant and facilities capable of processing up to 240 terrajoules a day (TJ/d) of gas, equating to ~86 petajoules per year (PJ/a) and with it up to 13,000 barrels per day of condensate.[7] Gas would be evacuated into the North Island transmission system and sold to market participants.

6 See PW O'Regan and TW Taylor, 'Joint Ventures and Operating Agreements' (1984) VUWLR 85 87.

7 Based on 2011 figures from Todd Energy's website where ~70 PJs of gas was produced and 3.9 mmbbls of condensate giving an approximate condensate to gas ratio of 1 PJ: 56,000 bbls of condensate.

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However, agreement could not be landed on the optimal gas marketing strategy. Todd wanted production at maximum rates, the full 86 PJ/a at 240 TJ/d per day, with sales on a take or pay basis, so that the facilities ran at maximum rates, within the bounds of good oilfield practice. Shell/OMV wanted to produce on a more conservative basis—70 PJ/a, an 'average' 195 TJ/d—and let the customer decide how much above or below the average that production should 'swing' each day. The commercial dynamics were quite simple: New Zealand is a closed market for gas supply with limited demand subject to new capacity for additional methanol being constructed. Todd already had the ability to sell gas with 'swing' from its 100 per cent owned fields, McKee and Mangahewa, and to balance its portfolio through its distribution business, Nova Energy. The Shell and OMV portfolios were more limited and without direct access to wholesale/retail markets. Sales with swing allowed the market to determine how much gas was in the market on any day and the conservative production profile would extend field life. In the absence of new demand, the Todd approach might flood the market resulting in a reduction in gas price that might negatively affect the value of Shell and OMV's respective New Zealand portfolios.

Shell/OMV decided to break the deadlock by abandoning joint gas sales and reverting to separate gas sales. After failed attempts to agree a gas balancing agreement (GBA), they used their majority vote on the Operating Committee to set annual production at 70 PJs pursuant to the annual production work programme and budget process. This left sufficient capacity in the facilities to support daily 'swing' of close to 20 per cent above average daily rates enabling higher offtake in the peak winter months and less over the off-peak summer. However, the effect was to defer annual production of 16 PJs of gas. With gas and condensate being produced together a consequential annual deferment of an estimated 900,000 barrels of condensate arose.

Joint gas sale contracts provide for the buyer to nominate production to the sellers directly. Without joint sales, a multi-party nomination framework needed to be introduced so the Operator could adjust daily production rates in response to buyer demands. Shell introduced the 'Offtake Rules' with associated nomination protocols that were approved by Shell and OMV voting affirmatively on the Operating Committee.[8] These rules and protocols required each producing Party to make daily nominations to the Operator for gas within defined time limitations in response to customer requirements. Provided each Party stayed within its annual share of 70 PJs a Party was entitled to nominate on a day up to its share of facility capacity or down to a minimum threshold with the intent, but not obligation, for each Party to take its share of 70 PJs over the year. If a Party failed to take its full annual entitlement it would be able to make up the underlifted portion by lifting at higher rates in subsequent years. Condensate produced with gas would be shared proportionate to participating interests regardless of gas nomination. These Offtake Rules were not without controversy within Shell. Through the discovery process the High Court saw correspondence from a Shell regional manager

[8] See paras [71] to [79] High Court judgment for a summary of the Offtake Rules.

(who appears to have been wrongly described as a 'legal officer') that made it quite clear that he thought the Offtake Rules needed unanimity.[9] He commented:

> Between us kids these are significant amendments to the JVOA[10]

Other internal Shell correspondence suggested that the Offtake Rules needed unanimity because they represented a 'property rights' issue.[11] Consequently, upon Todd's rejection of the Offtake Rules Shell continued to seek Todd's agreement. Shell and OMV acquired nearby pipelines to export condensate and required Todd to agree to the Offtake Rules to use them. Todd responded by building its own pipelines. Shell also refused to connect Todd's export pipelines to the Pohokura production station unless it agreed with the Offtake Rules. A resultant interim injunction enabled Todd to connect its pipelines but the annual production limit was left in place.[12] Todd brought proceedings in the High Court arguing the production limit and Offtake Rules were outside the jurisdiction of the Operating Committee to determine.[13] It argued that it was entitled to produce its 26 per cent share of gas at maximum rates, determined by the plant capacity. Damages quantified as between NZ$239 million and NZ$320 million were claimed for breach of contract representing the deferred gas and condensate production and lost sale opportunities between first gas in 2006 and the time of trial in 2010. Because the alleged breach continued past the High Court judgment, in 2014 in the Court of Appeal, Todd proposed to increase the sum claimed to account for the intervening five additional years in which production had been wrongfully constrained.

3. The High Court decision

The High Court trial took place from February through to April 2010. The key arguments in the High Court centred on the correct interpretation of Article 10 of the Pohokura JOA (that is near identical to Article 9 of the 1995 AIPN Model Form). Article 9 deals with the disposition of production—Article 9.1 setting out the general right and obligation of each Party to take its share of 'total production available'; Article 9.2 setting out the principles by which production volumes would be estimated and accepted for lifting and Article 9.3 that provides for the possibility of entry into 'special arrangements' for the disposal of gas.

9 The High Court wrongly described this individual as a Shell 'legal officer'. In fact at the time he was a 30-year veteran of the UK oil and gas industry. He was or went on to become Shell's Commercial Manager, Asia/Pacific region having joined when Shell acquired Enterprise Oil. There he had been the Commercial and Gas Manager of Enterprise's North Sea gas assets.

10 High Court judgment para [171].

11 Para [169] High Court although other correspondence noted that 'legal advice . . . seems to change depending which lawyer you ask'.

12 See the judgment of Harrison J in *Todd Pohokura v Shell Exploration NZ Ltd et ano* CIV-2006-485-1600, 3 August 2006.

13 CIV-2006-485-1600 (High Court), <https://forms.justice.govt.nz/search/Documents/pdf/jdo/1a/alfresco/service/api/node/content/workspace/SpacesStore/203c8408-7249-4a0b-a187-0f3779d38da1/203c8408-7249-4a0b-a187-0f3779d38da1.pdf> accessed 12 August 2015

Article 10.1

Todd's primary claim was that the Pohokura JOA empowered it to take its share of gas up to the capacity of the production facilities. This claim was based on Article 10.1 recited at paragraph [55] of the judgment as:

> Except as otherwise provided in this Article 10 or in Article 9 [Default], each Party shall have the right and obligation to own, take in kind and separately dispose of the share of <u>total production available</u> to it under this Agreement in such quantities and in accordance with such procedures as may be set forth in the offtake agreement referred to in Article 10.2 or in the special arrangements for Natural Gas referred to in Article 10.3 provided that Operator shall have the right and authority in conducting the Joint Operations to use or flare as much Petroleum as may be reasonably required by it, and the quantities so used or flared shall be excluded from production estimates to be provided by Operator. (emphasis added).

Todd drew the Court's attention, in particular, to the right and obligation of each Party to separately take its share of 'total production available'. Todd said that this meant, in the absence of any special arrangements for gas agreed under Article 10.3, that each Party was entitled and obliged to 'take' its share of the production that was available by virtue of the capacity of the Pohokura facilities, requiring production at maximum rates. Todd said that the Operating Committee had no power to artificially constrain production both because there was no express provision empowering it to do so and that it would be a breach of fiduciary duty to encourage Todd to sanction the plant with the capacity of 86 PJ/a and then constrain production to 70 PJ/a with a corresponding deferment of condensate production.

Todd also said that a failure by a Party (a 'non-lifting' Party) to take a share of production 'available' would be a breach of Article 10.1 inferring that if available production is determined by plant capacity then the failure of Shell/OMV to lift to maximum rates would be a breach of the obligation to take. In such an event, the other parties (the 'lifting' parties) could take the unlifted production with any redress available through principles established in US case law, which provide for how an overlifter would account in cash or in kind to an underlifter.

The Shell and OMV response was to point to the budgetary provisions which required the Operating Committee to annually approve the production work programme and budget, including the forecast annual production schedule. This, Shell argued, clearly left the determination of what production would be 'available' for taking within the power of the Operating Committee. Shell argued that there was no relevant fetter on how each Party voted at the Operating Committee allowing Shell and OMV to vote to produce conservatively. The suggestion that compensation for 'overlifts' be left to US case law was considered fraught with uncertainty and would almost certainly result in further litigation.

The High Court agreed with Shell. The Court confirmed that the determination of production rates was a matter within the power of the Operating Committee. After careful analysis of terms that may be implied into contracts or applicable fiduciary duties, the Court held that a Party was free to exercise its vote on the Operating Committee in its own commercial interests and that there was no obligation to vote in a manner supporting production at rates equating to maximum capacity. In evidence, Shell/OMV had demonstrated the plausibility of producing at conservative rates allowing the exploitation of the field's capacity to store production and sell gas with swing. The Court held that:

> without more, [there is no justification for] an interpretation of Article 10.1 enabling a minority venturer to force joint operations up to full capacity at all times, when a majority of the venturers seeks to exploit the resource at a somewhat lower average rate, subject to such decisions by a majority being challenged as irrational or perverse.[14]

The Court noted that Todd's insistence that production be maximized and lifted proportionately required it to acknowledge that if a Party did not take its share then such Party would be vulnerable to another Party or Parties taking the unlifted volume. The Court referenced a 'persistent theme' for Shell and OMV that Todd's interpretation involved an appropriation of the Joint Property without any compensation. The Court was unimpressed with the references to US case law that suggested an overlifter would have to account either in kind to an underlifter at a later stage in field life or in cash after field depletion.

Dobson J. held:

> I am satisfied that more would have been required to support an interpretation under which parties could be deprived of their share of returns on their investment as a result of underlifting. This would be particularly unlikely where the contract did not limit the circumstances in which a Party would lose property rights such as where it occurred for reasons beyond the underlifting Party's control or in circumstances considered to be reasonable at the time.[15]

Upon establishing that the annual production rate was a matter for the Operating Committee, and not determined by facility capacity, then it was held that the Operator was duty bound to produce to it. The court commented:

> Unless Article 10.1 is interpreted to impose the inflexible right and obligation Todd contends for, the balance of its arguments against the approach I have suggested lose their force. The role of the Operator is to manage the operations that accord with good oil field practice in the manner for which the Operator anticipates it will get budgetary approval. I am satisfied that proposals by the Operator incorporating a suggested level of production are within the appropriate content of the Operator's role.[16]

[14] Para [139] High Court.
[15] Para [142] High Court.
[16] Para [151] High Court.

Article 10.3

In regard to the Offtake Rules, Todd argued that their promulgation was outside the scope of the Operating Committee's power because they authorized the Operator to limit production to less than what would be otherwise 'available' if the Operator produced to plant capacity. Production on this basis, said Todd, would not be in accordance with the JOA and therefore could not be within the definition of 'Joint Operations'. Joint Operations were defined as per the 1995 Model Form as:

> those operations and activities carried out by Operator pursuant to this Agreement, the costs of which are chargeable to all Parties.

With the Operating Committee's powers being constrained to the supervision of 'Joint Operations', a decision relating to activities falling outside the definition would be invalid.[17] Todd also contended that the Offtake Rules amounted to a gas offtake regime that fell within the exclusive scope of Article 10.3. The Court set Article 10.3 out in full at paragraph [55] as:

> The Parties may enter into special arrangements for the disposal of Natural Gas which are consistent with the Development Plan and subject to the terms of the Permit. These arrangements may provide for joint marketing and sales of Natural Gas as may be agreed between the Parties from time to time.

The natural meaning of Article 10.3, said Todd, was that all the Parties had to agree to the 'special arrangements' and that it was not a matter for the Operating Committee.

Shell/OMV responded that Article 10.3 provided for the Parties to enter into 'special arrangements' for gas and that this must be something less than an 'agreement' and could therefore be a procedure promulgated by the Operating Committee pursuant to the wide powers to regulate Joint Operations conferred under the JOA. In the alternative Article 5.2(1) of the Pohokura JOA, Shell said, empowered the Operating Committee to promulgate the Offtake Rules. Article 5.2(1) was recorded[18] as stating:

> The Operating Committee shall have power and duty to authorize and supervise Joint Operations that are necessary or desirable to fulfil in a timely manner the terms of the Permit and properly explore and exploit the Permit Area in accordance with this Agreement and in a manner appropriate in the circumstances. Without limiting the generality of the foregoing, but subject to the other provisions of this Agreement, the powers and duties of the Operating Committee shall include:

[17] In a separate and alternative action, Todd argued that the Offtake Rules had the effect or purpose of substantially lessening competition under s 27 to s 29 Commerce Act or amounted to price fixing under s 30 and were therefore unenforceable under New Zealand's competition law. This alternative argument ultimately failed in both the High Court and the Court of Appeal but is not within the scope of this article.

[18] Paras [107] and [108] of the High Court judgment.

> (1) the consideration and the determination of all matters relating to general policies, procedures and methods of operation under this Agreement including the Safety, Health and Environmental Policy;[19]

This, Shell said, empowered the Operating Committee to supervise and authorize all Joint Operations and to develop policies and procedures in respect thereto that were necessary and desirable to properly exploit the permit area.

Again the Court favoured the Shell approach. It analysed the oil nomination and lifting procedures set out in the Pohokura JOA[20] (that are in all material respects the same as Article 9.2 of the 1995 Model Form JOA) by which oil would be nominated and lifted, noting the requirement that binding principles would apply pending their incorporation into a fully termed offtake agreement to be concluded unanimously. It considered the provision for the 'elimination of overlifts and underlifts' and that:

> in Article 10.2(D), the arrangements contemplated for the disposition of oil explicitly recognise the prospect of underlifting and overlifting. There is nothing in the terms of the JVOA to suggest that arrangements for transformation of joint into separate property should be different as between one form of production of the venture (oil), and the other (gas).[21]

The Court held that this, along with the flexibility for the Operating Committee to determine production rates, suggests that the terms of the JOA contemplate a measure of flexibility and that ensuring that imbalances can be redressed are also a matter of commercial common sense.[22] It observed that the entry into 'special arrangements' by the Parties must necessarily be different to a unanimously agreed 'agreement' as contemplated for oil. It found that the only decision making forum for the joint venture is the Operating Committee that provided for decisions by majority vote, and held that in the absence of unanimity, rules setting out how gas is lifted from common stream and vested in each Party would be necessary to operationalize the JOA. Those rules could be imposed by the Operating Committee either as a 'special arrangement' or as a policy or procedure that the Operating Committee was entitled to promulgate to fill 'gaps in more formal arrangements between the Parties sufficient to enable the [JOA] to work'.[23]

Court of Appeal

Todd appealed to the Court of Appeal, New Zealand's second highest court, below the Supreme Court that had replaced the Privy Council from 2004. During the hearing, that took place in September 2014, Todd clarified that its insistence that production be lifted

[19] Recited at para [51] of the High Court judgment.
[20] Set out at para [137] of the Court of Appeal judgment.
[21] Para [143] High Court.
[22] Para [178] High Court.
[23] Para [181] High Court.

proportionately did not necessarily require proportionate lifting 'every minute of every hour of every day', which might lead to the inflexible outcome that the High Court found could result in inequitable outcomes. Instead it argued that a Party's obligation to lift its proportionate share could be discharged over the field life across the term of the JOA, a 'reading down' of the obligation to lift, providing some flexibility for each Party to choose when it wished to take its production entitlement. This would leave the Parties free to lift up to their share of production at maximum rates. Once an overlifter had taken its share of estimated reserves it would have to cease taking production until the other Parties 'caught up', or if the field had depleted, by cash settlement in accordance with US case law that set out principles by which cash compensation could be calculated.

In what the Court described as a 'new' argument, Todd emphasized the importance of Article 10.2's oil production and lifting procedures. In particular, it was not disputed that as Pohokura produced 'oil'[24] the production and lifting principles were binding and effective. Todd was accordingly entitled to rely on those procedures as the primary mechanism by which production, including gas, would be nominated and produced and that they could not properly function as intended if a nomination regime for gas, which would produce oil, was being operated in parallel. Todd claimed that the oil lifting procedures encouraged maximum production rates as each Party was required to lift their 'entire' share with rights for a Party to lift any untaken 'Entitlement', defined to include gas and oil, and dispose of it as a 'sale option', accounting to the non-lifting owner subsequently. Displacing the oil nomination procedures with gas Offtake Rules would need unanimity.

The Court of Appeal rejected all of Todd's points on appeal.[25] It considered the potential for Todd, as an overlifter, agreeing to halt taking production when it had taken its share of production as fraught with uncertainty and likely to result in further litigation. It agreed with the High Court analysis and observed that the US case law applies to a different regime to New Zealand's. It dismissed the oil production and nomination provisions as not furthering Todd's case for maximum production under Article 10.1 because oil production rates, just like gas, must first be determined by the Operating Committee. It held that while an offtake agreement for oil needed unanimity and that the Offtake Rules set up an arrangement for gas similar to what is contemplated for oil, in the absence of unanimity, the Operating Committee could impose rules to deal with gas offtake under Article 10.3.

4. Case analysis

Todd's arguments all proceeded on the basis that its interpretation of Article 10.1 was correct—that is, that it was the plant's capacity that determined the amount of production that was to be available, not the Operating Committee. As discussed in more detail below, this interpretation is at odds with industry practice at least in the North Sea, where

[24] Condensate from Pohokura falls within the definition of 'oil' under the JOA.
[25] [2015] NZCA 71.

Operating Committee's routinely convene to discuss the annual work programme and budget, a necessary part of which are the daily and annual target production rates. The Court of Appeal held:

> [143] . . . Todd's argument under art 10.3 has two strands. The first depends on its fundamental proposition about the proper interpretation of art 10.1. The second is the contention the Operating Committee exceeded its powers when it purported to adopt the offtake rules and nomination protocols over Todd's opposition. Ultimately, the second point depends on the first, and we do not accept Todd's argument about the meaning of art 10.1 for reasons already addressed. (emphasis added)[26]

With respect, it was open to the Court of Appeal to find for Todd on the 'second point' independently of the first point—that is that the Operating Committee may determine annual production rates but that lifting would have to be proportionate to Participating Interest—the Offtake Rules are consequently invalid. As Shell's own internal correspondence suggested, 'between us kids', they infringe property rights developed by the common law and adopted into the 1995 AIPN Model Form and the Pohokura JOA.

5. Common law extraction rights

Exploration and production activities have been undertaken in the context of the applicable underlying common law rights, in particular, in the context of the rights of co-tenants to exploit a mineral resource. The applicable law mixes principles of tort, real and personal property, contract and the law of bailment. 'Common law', being 'judge made' law, may vary from case to case as well as jurisdiction to jurisdiction. In the context of gas imbalances, Patrick Martin notes:

> Our attitudes towards imbalances and our beliefs about the law will be shaped by the equities we perceive in the manner in which the imbalance arose.[27]

In the absence of an agreed contractual mechanism, how the common law might determine each case will be specific to the circumstances and where the court finds the equities to lie. The following principles that are relevant to mineral ownership, extraction and removal should be considered:

Ad coelom

Under the doctrine of ad coelom, a landowner owns both the rights to the land's surface and everything above and below it as well. This includes any minerals beneath the surface of a parcel of land. However, oil and gas are 'migratory' minerals—they move underground depending on pressure changes—and they can be extracted from an adjacent

[26] Para [143] Court of Appeal.

[27] Patrick Martin, '*The Gas Balancing Agreement is What When, Why and How?*' (Rocky Mineral Law Institute, Proceedings of the 36th Annual Institute, July 19, 20 and 21, 1990) ch 13.02(1), 4.

parcel of land if a well relieves pressure and causes the movement of petroleum towards it. Ownership of such migratory minerals followed the same rule applying to that of wild animals—the 'law of capture' where a surface owner only acquired property rights in an animal on his land when it was reduced to his possession and 'captured'.[28] Once petroleum is 'captured' it ceases being part of the 'real' property and becomes the capturing owner's personal property.

Profits à Prendre

An owner of land may permit another to enter onto his property and remove the mineral resources. Such rights are known as 'profits à prendre' and are counted as 'land' for the purposes of the tort of trespass to land.[29] In the UK, the doctrine of *ad coelom* has been modified for Crown minerals. The 'landowner' of the petroleum estate is the Crown and the petroleum legislation provides for rights to extract the resource and take good title once it has been lawfully obtained or 'captured'. This framework is replicated in New Zealand with mineral extraction rights under Crown permits recognized as akin to a profit à prendre.[30] Under Section 10 of the CMA, the title to all petroleum *in situ* is vested in the Crown. Title may then transfer to a 'permit holder' (who may be more than one party) under section 31 once it has been lawfully obtained or 'captured'.

Ownership of minerals

In the USA the doctrine of *ad coelom* survived. It is the land's surface owner that has title to the subsurface petroleum estate. Owners may lease their property to oil companies and collect a royalty on resultant production.[31]

This subtle distinction in the ownership of minerals *in situ* is important to how the common law of the respective jurisdictions have developed and legislative interventions from time to time. The US common law has a long history of cases involving small landowner lessors, complaining that the conduct of the larger oil company, lessees, have been unfair. The Courts have been willing to imply obligations upon lessees in petroleum leases to protect the 'mom and pop' landowners. Texas attorney, John McFarland, recounts that:

> In Texas, the Supreme Court has described those implied obligations as a duty ''(1) to develop the premises, (2) to protect the leasehold, and (3) to manage and administer the lease.'' Amoco v. Alexander, 622 S.W.2d 563, 567 (Tex. 1981). Other commentators have described these implied obligations as a duty to (1) develop the lease, (2) protect the lease against drainage, (3) market production, and (4) act as a reasonably

[28] See RD Chamberlain commentary on the law of capture in, 'A New Dimension in the Ratable Taking of Natural Gas in Oklahoma: Enrolled House Bill 1221' (1984) 20 Tulsa L J 77, 77–81 and M Hammerson's commentary in, *Upstream Oil and Gas: Cases, Materials and Commentary* (Globe law and Business 2011) ch 3.

[29] *Halsbury's Laws of England* (4th edn (re-issue), Butterworths 2008) vol 16(2), para 254 and Todd's *The Law of Torts in New Zealand* (5th edn, Brookers Ltd 2009) para 9.2.03.

[30] See the dicta of Cooke P in *Tainui Maori Trust Board v Attorney-General* [1989] 2 NZLR 513 where coal mining rights were held to have the same effect for all purposes as a *profits a prendre*.

[31] Under the AAPL form, 8% of the production is the standard royalty charge.

> prudent operator. Courts have held that these obligations are implied in every lease unless the lease expressly disclaims the duties.[32]

Furthermore, the US system encouraged competitive drilling—with the rule of capture applying it would be possible for the owner of an adjacent property to drain the reserves from its neighbour. The only protective measure to be taken was to drain it first. This resulted in an oversupply of gas and oil and the costly duplication of production facilities and pipelines, all of which acted to the detriment of the underlying lessor and ultimately a reduction in tax collected by the relevant State. To ameliorate these outcomes, the legislature of many oil producing states enacted laws regulating production rates and to eliminate wasteful development.[33]

In New Zealand, like the UK, the Crown owns all petroleum *in situ* and issues petroleum permits for its extraction. It is well positioned to ensure that its interest, as a royalty owner, is properly protected where it might diverge from those of the permit participants. The UK implies the 'model clauses' into the licence, whereas the terms of the applicable 'petroleum programme' are implied into each New Zealand mining permit. These instruments flesh out the detail of the permit obligations and how the extraction, development, production and abandonment processes must be conducted in accordance with good oil field practice, including covenants against wasteful activities. A development cannot move ahead without the approval of the Government royalty owner. It has an over-riding right to approve facility development as part of the FDP approval process. With the Crown holding an interest in every mining permit, its position as a royalty owner is far removed from that of the 'moms and pop' lessors in the oil producing states.

Co-ownership

Where two or more parties share a profit à prendre then the principles of co-ownership apply. Historically, the common law allowed each co-tenant in the fee to unilaterally remove minerals from land held in common without the need to account to the other co-owners. From 1265, after the Statute of Westminster II was enacted, such unilateral actions could be the subject of a writ of waste in favour of one co-tenant against another. There were two remedies available after a successful suit. The defendant could either accept a partition in kind of the land and take its share, less the minerals that it had already removed, or he could halt further activity until his co-tenants had 'caught up' and removed a matching volume of minerals.

Another remedy, an action for account, became available in 1705 by the Statute of Anne. This law provided that:

> Actions of accounts shall and may be brought and maintained against the executors and administrators of every guardian, bailiff and receiver; and by one joint tenant and

[32] See *Oil and Gas Lawyer Blog* at <http://www.oilandgaslawyerblog.com/2015/01/the-oil-and-gas-lease-part-v.html> accessed 12 August 2015

[33] See Chamberlain (n 28).

> tenant in common, his executors and administrators, against the other, for receiving more than comes to his just share or proportion . . ..

In the USA, many hundreds of co-tenants could jointly own a mineral deposit.[34] To facilitate petroleum activity, many oil producing states in the USA apply the doctrine of 'majority rules' which allows a majority of co-tenants to move forward with a development against the wishes of the minority subject to accounting to the minority for their share of proceeds, less the proportionate share of development costs. Other states apply the 'minority view' that treats exploitation of oil and gas by one co-tenant without permission of all co-tenants as actionable waste, requiring an account for profits.[35]

These remedies form the basis of the modern day common law principles applicable in the UK, New Zealand, the USA and other jurisdictions. Although each jurisdiction has since developed in its own manner by way of case precedent and statutory intervention, it should be remembered that New Zealand has historically followed the UK approach very closely and, given the similarity in the petroleum legislation, the UK is likely to provide a closer analogue than other jurisdictions, including the USA.

Under these principles of co-ownership, the permit holders in New Zealand would be joint tenants whereby each would have an ownership right in every gas molecule. The sale by one would require the proceeds to be shared with the others. However, JOAs divide ownership of all 'Joint Property', including the rights under a mining permit, among the owners in proportion to their respective contributions, their 'Participating Interests'. This division alters the co-tenancy to a tenancy in common whereby each Party has an undivided but defined proportionate share to the petroleum estate and use of the joint property. The chief attribute of a tenancy in common is unity of possession. All co-tenants to a tenancy in common share a single right to possession of the entire interest until the tenancy in common is broken.[36] In the case of production, the tenancy in common ends when production is delivered and possession taken, - the 'capture' by each owner of its proportionate share of production.

Bailment

The nature of extracting, processing and delivery of each Party's share of production is akin to a bailment. The JOA itself could be viewed as a form of contract for bailment where the owners, each a bailor, cede possessory rights to their share in the production to the Operator, the bailee, who is authorized to take possession of their undivided shares in production, to process it according to the production work programme and deliver it to them pursuant to the approved production schedule. Any untaken production places the Operator in the position of an 'involuntary bailee' where its duty is to act reasonably in all

[34] For example, *Law v Heck Oil Co* 145 SE 601 (W Va 1928) involved 765 cotenants.

[35] See O Anderson and M Cuda's, 'The Nonconsenting Cotenant in Oil and Gas Development: The Oil Patch Version of the "Little Red Hen"' (1992) 12 Min L Inst 16–17, para 10.03 for a full description of the principle 'majority view' and para 1604 for the 'minority view'.

[36] *Powell on Real Property* s 601[1] (Matthew Bender 1989). Cited in Patrick Martin's, *'The Gas Balancing Agreement is What When, Why and How?'* (Rocky Mineral Law Institute, Proceedings of the 36th Annual Institute, July 19, 20 and 21, 1990) ch 13.02(1), 5.

the circumstances.[37] The Operator has the right, and is even under a duty, to deliver the untaken production according to the production schedule and, if still not taken by the non-lifter, then to procure its sale and removal, with the proviso it accounts for any proceeds, less expenses.[38] In this case no conversion arises—the Operator is merely delivering according to the terms of the bailment and by selling the untaken production and accounting is acting reasonably in all the circumstances. In New Zealand, title may transfer to the buyer under section 3 of the Mercantile Law Act 1908 if the seller qualifies as a mercantile agent, under a common law right of sale or a court ordered sale.[39] Alternatively, the bailment might be treated as a contract of carriage, and if so the Carriage of Goods Act 1979 would allow the Operator, the carrier, to dispose of untaken production that, due to pressure build up, became dangerous.[40] These rights should be contrasted with the position of a Party that deliberately takes another party's share. The offence is one of conversion where the accounting is for the 'market value' of the goods at the time of conversion and not just for the proceeds of a sale which, if at short notice, might be significantly less than the market value.

Conversion

As Shell's internal correspondence noted, because the JOA divides ownership, personal property rights arise in the production the instant it is produced and 'captured' by the joint venture at the wellhead. A Party that takes another Party's unlifted share of production, an overlifter, may be guilty of conversion if it has misappropriated another's property and the old common law remedy of trover would apply allowing a return of the goods or, more practically, damages to their value at the time of the conversion.

In the case of an underlift, if untaken production is not removed then the joint venture will be forced to store the non-lifting Party's untaken share in the facilities. For oil a certain amount of leeway is afforded depending on what storage may be available and any 'borrow and loan' arrangements that the Parties may have agreed.[41] Lifting Parties may continue to lift their share from the tanks but if the failure continues the storage tanks will soon be filled with the non-lifter's oil necessitating a halt in production or the lifting of the non-lifter's share, resulting in an overlift by the Party willing to lift. The same principle applies to a failure to take gas. Subject to any available linepack that might offer short-term storage, or a gas balancing agreement, the joint venture becomes an involuntary bailee—it remains in possession of a non-lifting Party's share of production past the time due for its delivery. In short order, the facilities would overreach safe pressure limits

37 See S Todd, J Burrows and J Finn, *Contract Law in New Zealand* (2nd edn, Kluwer Law International 2014) 247. Who cite Houghland v. RR Low (Luxury Coaches) Ltd [1962] 1QB 694 with approval.

38 See *The Winkfield,* 1900–1903 All ER 346, judgment of Collins MR 'As between bailor and bailee the real interests of each must be inquired into, and, as the bailee has to account for the thing bailed, so he must account for that which has become its equivalent and now represents it' 61–62. This principle was accepted as correct under New Zealand law in *NZ Securities & Finance Ltd v Wrightcars Ltd* [1976] 1NZLR 77.

39 S 23(2) of the Sale of Goods Act 1908 (NZ).

40 S 26 Carriage of Goods Act 1908 (NZ).

41 'Borrow and loan' arrangements allow the taking by a party of more or less production than it has in storage to match the ullage available in a loading tankship with the intent that the tanker is always filled. This is contemplated under art 10.2 of the Pohokura JOA.

meaning production would either need to be removed, with the overlift consequence, or further extraction activities halted.

However, under New Zealand law conversion is committed only when the defendant converts to his own use, or wrongfully deprives the plaintiff of the use and possession of the plaintiff's goods. It is necessary that the defendant's act amounts to a wrongful interference with the plaintiff's goods.[42] It is submitted that in the case where a Party fails to take its share of production, effectively waiving its right to possession and thereby forcing the other parties to remove the offending production, the elements for the tort of conversion are not met. Provided the lifting Party acts reasonably in the circumstances and accounts to the true owner for the sale proceeds, less expenses, it will not be deemed an overlifter and balance will be maintained.

Trespass to Land

In the failure to lift scenario described above, the exclusion of a co-tenant's right to enjoy its share of the profit à prendre and access the plant capacity may also give rise to a trespass to land action. If so, in New Zealand, the self-help remedy of 'expulsion' might be available allowing the removal and disposition of the trespasser's untaken production.[43] It is similarly submitted that where the equities favour the lifting Party and he acts reasonably and accounts for any proceeds, less expenses, then no overlift will have occurred and balance will be maintained.

6. Development of the AIPN Model Form JOA

Leaving the question of how untaken property should be dealt with to the many strands of the common law is an unsatisfactory outcome that militates against the large financial investments common to oil field developments. A Party could seek a declaration from the Courts in advance, but otherwise JOAs attempt to displace unpredictable common law principles, as supplemented by general statute, with agreed mechanisms prescribed under contract. In particular, when and to what extent the real property rights associated with the profit à prendre are exercised are prescribed in the JOA along with personal property rights and obligations associated with the removal of a share of produced petroleum.

AAPL and BNOC

The production and offtake provisions from the JOA developed by the Association of Petroleum Landmen (AAPL) and that of the British National Oil Company (BNOC), featured prominently in the development of the AIPN's 1990 Model Form and the 1995 update that applied to Pohokura. In respect to the AAPL Tim Martin and Jay Park comment:

> The North American oil industry evolved in an environment where there were a large number of landowners who held rights to subsurface minerals. Consequently, 'land-men' was the name given to the professionals at the oil companies who dealt with

[42] Todd's *The Law of Torts in New Zealand* (5th edn, Brookers Ltd 2009) 549.
[43] ibid ch 9.2., especially pp. 435–436.

> these landowners, by initially negotiating for the grant of rights to the subsurface and for access to the surface, and then later managing the relationship with the landowners and other companies active in the same area. As their competency and duties expanded, a professional organization was created in the United States to address industry issues: the American Association of Petroleum Landmen (AAPL).[44]

The AAPL's form was first issued in 1956, then updated in 1977, 1982 and 1989. On the other side of the Atlantic:

> the creation by the Labour government of the state-owned British National Oil Corporation and the policy of forcing participation in licences by BNOC had one positive outcome – the creation at the time of the Fifth Round of Licensing of a model-form Joint Operating Agreement. This document became a North Sea standard and remains in use in modified form today. It is interesting to speculate whether the industry would ever have agreed upon a model-form JOA had one not been forced upon it.[45]

Former AIPN president, Mick Jarvis recalls that 'this politically driven mandate required BNOC have [a] pretty free hand as to how and when they would lift, requiring less control for the Operator'.[46] BNOC tried to impose its version on the industry but it was opposed and a negotiated JOA emerged. It was adopted by the UK's Offshore Operator's Association (UKOOA) and re-formulated for the 20th round of licensing in 2002 and then again, in 2008 by UKOOA's successor, Oil & Gas UK.[47]

The AIPN published its first model form international JOA in 1990. This was followed by updated versions published successively in 1995, 2002 and 2012.

Determination of production rates

With international E&P activities being undertaken by large multinationals, the AIPN's model form drafting committee made a concerted effort to move away from the US operator biased framework to one that provided non-operators with more say in how Joint Operations would be conducted. In doing so, it adopted the Operating Committee structure set out in the BNOC form. BNOC was a non-operator and therefore the BNOC form provided many more rights for the non-operators to control the Operator through the Operating Committee.

This was a significant departure from the AAPL form that was prevalent in the USA. There is no Operating Committee under the AAPL JOA and no process to determine what a production programme might contain or how production rates are determined. The JOA is entered into by lease holders and others with 'oil interests'. The underlying leases provide title to all oil and gas in the reservoir with the land owner lessors receiving

44 Martin and Park (n 1).

45 MR David (ed), *Upstream Oil and Gas Agreements* (Sweet & Maxwell 1996) 7.

46 Email interview conducted 22 May 2015.

47 The author was a member of the 2008 model's drafting sub-committee.

a royalty based on production. With the possibility of a reservoir spreading across multiple land holdings, the number of parties to a JOA can be counted in the hundreds in contrast to the low single digits commonly encountered internationally.

The AAPL JOA envisages the Operator drilling an 'initial well' and, after completed, decisions regarding rates of production are left exclusively to the Operator. Article V states:

> Operator shall be an independent contractor not subject to the control or direction of the Non-Operators . . . Operator shall conduct its activities under this agreement as a reasonable prudent Operator, in a good and workmanlike manner, with due diligence and dispatch, in accordance with good oilfield practice, . . .

As *Taylor and Winsor* observe in regards to US JOAs:

> the Operator is expected to get on with the job without interference from non-operators whose role is essentially that of investors rather than active participants. The non-operators therefore have little influence over the manner in which operations are conducted . . ..[48]

Accordingly, in the absence of a supervising Operating Committee, the Operator is left to produce in accordance with good oilfield practice, a feature of which is production at 'maximum efficient rates' where the reservoir and well are adequately protected but without any constraints driven by wider commercial considerations except those pertinent to the 'initial well'. This industry practice is supportive of Todd's interpretation of Article 10.1 and the volume of production 'available' for lifting.

Conversely, the UK model, as updated in 2002 and thereafter again in 2008, sets out how the Operator develops the various annual work programmes and the process for their revision and approval by the Operating Committee. The Operator is required to deliver its proposed work programme and budget and in respect to production:

> an estimate of the date of commencement of production (if appropriate) and of the monthly total production for each major production stream and injection stream and the maximum daily rate to be achieved for each such stream in each month.[49]

Thereafter the Operating Committee is required to consider, revise and finally approve the programme including the daily production rates. This practice is reflected in the AIPN models where the operator must produce a production schedule for the following year, which should include the proposed daily rates. This industry practice makes plain that it is the Operating Committee that exclusively determines production rates, which

[48] M Taylor and T Winsor, *Joint Operating Agreements* (2nd edn, Longman Law Tax and Financing 1992) xxiv.
[49] UKOOA 20th Round JOA clause 13.1.2.

are the collective exercise of rights under the profit à prendre, but is in direct contrast to Todd's interpretation of Article 10.1, where production is determined by facility capacity.

Fetters on the operating committee's discretion

Once the opportunity for determining 'maximum efficient rates' of production was handed to the non-operators under the BNOC form, considerations pertinent to each of them, their portfolio and wider commercial interests, and not just the 'initial well' became relevant. To deal with possible conflicts of interest *Taylor and Winsor* note:

> Where it is clear that conflicts of interest will arise e.g. where a licensee has an ownership interest in processing facilities in a producing field, but also wishes to use those facilities for its production under another licence, the licensees may agree procedures amongst themselves whereby any Party with such a conflict of interest has the right to elect which of its divergent interests to represent when issues arise requiring a vote. Procedures along these lines have been added to a number of UKCS JOAs.[50]

Such conflict of interest clauses were not included in the UK model forms possibly because such clauses worked to protect non-operators, whereas the pen for the UK model form was, and still is, firmly held by the major offshore Operators. Such clauses need to be included during the JOA negotiations.[51]

The AIPN model forms introduce this supervisory Operating Committee with broad discretion to determine matters relating to Joint Operations including the approval of the production schedule. The Pohokura corollary, set out in full at paragraph [119] of the Court of Appeal judgment, requires this schedule to be 'firm' for the following year and 'contingent' for the year after that to enable estimation by each Party of their annual revenues and budgets. Like the UK models, there are no relevant fetters on how each Party should vote when it comes to production rates and it would appear that the Pohokura partners did not include language in the JOA such as that suggested by *Taylor and Winsor.*

Ownership and offtake

There is more consistency between the UK and US approach to ownership of extracted production and rights to its offtake. Under Article III.B of the AAPL model form, all petroleum is owned proportionate to the interests set out in Exhibit A to the form. Pursuant to Article VI.G, each Party is to take (or separately dispose of) its own share of production that is produced. Clause 4 of the UK model provides for ownership to be similarly divided by stated participating interests. With the Crown owning the production *in situ*, the ownership provisions that are relevant to the parties can only apply to

50 Taylor and Winsor (n 48) 30.

51 For example, language from a negotiated JOA of the author's from 1999 states: 'provided that . . . any change to the production profile shall always be made in consideration of conditions imposed by, inter alia, the maximum economic rate of production consistent with good oil field.'

produced petroleum. This is also reflected in Article 3.3(A) of the AIPN models. Under the Pohokura JOA, the term 'Joint Property' includes any petroleum acquired pursuant to 'Joint Operations'. It is vested in each Party from the Crown in undivided shares proportionate to Participating Interest, prior to custody, ownership and control transferring as provided by Article 10 (disposition of production).

This 'proportionate sharing' rule where production is owned according to participating interest is a cornerstone of most JOAs. It ensures that the starting position is for each Party to take and separately dispose of its share of production equivalent to its share of capital invested. As discussed earlier, a claim in conversion may arise if a Party wrongfully takes more than its share by taking another Party's production and an action in trespass or breach of bailment might lie if it takes less. As such, the proportionate sharing rule may only be altered by the express terms of the JOA or other unanimously agreed agreement. For example, the default provisions allow the Operator to take a defaulting Party's share and offtake arrangements in the AAPL and AIPN forms envisage the Operator disposing of untaken production.

However, how, when and even if production vests is quite different between the UK and USA. In the US, the lease holders 'own' the production *in situ* meaning that a 'share' of production could mean the share of hydrocarbons held in the reservoir. It could therefore be argued that the requirement to take that share could be exercised when chosen by each Party over the term of the JOA.[52] Further, in a 'majority rules' state the entitlement to receive production 'in kind' by a non-consenting minority owner is replaced in favour of an accounting for profits leaving the method and rate of production to the majority to determine. The UK and New Zealand have quite a different process. Title to production is vested in the Crown. When it is produced and 'captured' by the joint venture, it vests, first from the Crown to the permit participants jointly, as co-tenants,[53] and secondly, and instantaneously, in each of the Parties, as tenants in common, in undivided shares that are proportionate to their participating interests. Unless specified elsewhere, once the property has vested in each Party the general law applicable to property applies. A fundamental principle of property ownership is that the true owner is entitled to possession to the exclusion of others and any interference with this right is actionable—for land in trespass, for personal property, in conversion. For tenants in common, the possessory title is shared and each co-tenant is entitled to possession and use of its share.

AAPL offtake

Under the AAPL form, Article VI.G, *Taking production in kind option 2* provides an offtake regime that will apply where no GBA has been agreed. It contains a default mechanism to apply where a Party fails to lift its entitlement:

[52] It should be noted however that the AAPL Model Form requires each Party to lift its share of oil and gas 'produced', suggesting that the obligation to take under that form arises at the time of production.

[53] In New Zealand pursuant to s 31 Crown Minerals Act.

> If any Party fails to make the arrangements necessary to take in kind or separately dispose of its proportionate share of the Oil and/or Gas . . . Operator shall have the right, subject to the revocation at will by the Party owning it, . . . to purchase such Oil and/or Gas or sell it to others at any time and from time to time, for the account of the non-taking Party . . .. Any purchase or sale by Operator of any other Party's share of Oil and/or Gas shall be only for such reasonable periods of time as are consistent with the minimum needs of the industry under the particular circumstances, but in no event for a period in excess of one (1) year.

This process, by which the Operator can sell untaken production, as described in Article VI.G, was adopted into the AIPN's 1990 Model form at Article 9.2(H).[54] This provides a framework by which an Operator may sell untaken production provided profits are accounted for as enshrined in the Statue of Anne and similar in nature to the requirement to account under 'majority rule'. Article 9.2 of the AIPN Model Form is entitled 'Disposition of Crude Oil' however, it has a much broader operational effect in that it deals with the estimated volume and nomination of 'production', ie oil and gas, and the process to apply where a Party fails to take its 'Entitlement' where such failure is likely to cause a curtailment of production. It works in tandem with the 'firm production schedule' that is to be approved under the production work programme and budget so that each Party understands how much production will be delivered, and when, so that it may make appropriate evacuation arrangements.

Article 9.2(H) is the AIPN's attempt to prioritize the competing common law principles applicable when a Party fails to take its share of production. While Article VI of the AAPL form expressly applies to untaken gas and oil it could be argued that the 'sale option' process envisaged by the AIPN as being embedded in the oil offtake agreement is intended to only apply to untaken oil. However, such a narrow interpretation would erode significant utility from Article 9.2(H). Quite aside from 'Entitlement' being expressly defined to include oil and gas, it is designed to ensure that untaken Entitlement does not cause a curtailment of production which is the outcome when one Party does not take its full share of gas where, as at Pohokura, gas and oil are produced together. If the gas is not produced then neither is the oil. As such, it is submitted that for Article 9.2(H) to function as intended, it must also be capable of dealing with untaken gas in the absence of 'special arrangements', such as a gas balancing agreement, for gas disposition.

This 'purposive' interpretation of Article 9.2(H), and its Pohokura corollary, 10.2(H),[55] although providing a process by which gas or oil entitlements could remain in balance by cash settlement is not a GBA, which provides for balancing in kind. As

[54] Confirmed by Mick Jarvis. While Jim Barnes' recollection is that art 9.2 reflects standard crude oil lifting provisions given Andrew Derman's familiarity with the AAPL form, it seems likely that the key concepts arose from that agreement.

[55] Set out at para [137] of the Court of Appeal judgment.

Andrew Derman, co-chair of the AIPN JOA model form drafting committee, states in his commentary on Article VI.G (no GBA) of the AAPL JOA:[56]

> The use of Option No. 2 continues to be deceptive. It can give parties a false sense of comfort that a Gas Balancing Agreement is not necessary. All Option No. 2 does is give [a Party] the right to buy the [non-lifting Party's] oil and gas . . . . The use of Option No. 2 is not a substitute for a Gas Balancing Agreement.

Even if Article 9.2(H) does not extend the 'sale option' for untaken gas, the underlying common law described above would work to give the Operator the right, and duty, to procure the removal of untaken gas that is causing production constraints, provided it accounted for any proceeds less sale and other costs incurred.

UK models—offtake

The UK model forms provide for another regime in regards to offtake. For oil, clause 13.3 of the 20th round form is quite inflexible, requiring each Party to lift their share or else lose it ('lift it or lose it'), a reflection of the rule of capture where untaken production is deemed 'abandoned' so that title vests in another Party when it takes possession. There is no need for the Operator to take the unlifted share, sell it and account. For gas (and NGLs) 'special arrangements' for offtake are left as an 'agreement to agree':

> 17.2 NGLs and Natural Gas
> The Participants recognise that, in the event of the production of NGLs or Natural Gas, it may or will become desirable for them to enter into special arrangements for the disposal of the same and they agree that, in such event and upon the request of any of them, their respective representatives shall meet together as necessary to consider their entry into such arrangements and that, if and to the extent that any such arrangements are agreed, they will adopt and undertake the same.[57]

In respect to 'special arrangements' under the AIPN forms Andrew Derman states:

> It is impossible to properly prognosticate a gas offtake agreement. As such, the Model Form, like that of most operating agreements, does not even attempt to include a summary of the most salient provisions. The Model Form does no more than recognize that at some future date the Parties will enter into a gas offtake agreement.[58]

This 'agreement to agree' regime is in direct contrast to the High Court's finding at paragraph [180] that ''it would deprive the JVOA of significant utility if it was merely an

[56] In his commentary of the AAPL 1989 model form, *The New and Improved Joint Operating Agreement: A Working Manual, 1991*, 71, <http://www.tklaw.com/andy-derman/> accessed 12 August 2015

[57] Clause 17.2 UKOOA 20th Round JOA.

[58] AB Derman, *Model Form International Operating Agreement An Analysis and Interpretation of the 1995 Form*, Natural Resource Law Section, American Bar Association Monograph, No 23, 31.

agreement to agree in respect of gas . . . '' It is likely that the AIPN Model Form Article 9.3 has been influenced by the UK 'special arrangements' language so it is perhaps worth recalling how the UK's gas industry functioned at the time BNOC's JOA was developed.[59]

7. UK gas

The UK gas industry was far less developed in the 1970s when compared to the USA. It had a separate and closed domestic market, controlled by British Gas, the state monopsony gas buyer which purchased under long-term joint gas sales agreements. British Gas had a significant influence over which gas fields were developed and when. Fields high in oil and condensate were paid less for their gas than those in the Southern North Sea that had a higher dry gas content because the value of liquids meant the joint venture would produce anyway. Gas was often treated as a by-product and was delivered to British Gas when produced with oil.

British Gas required the dry gas producers in the Southern North Sea to supply gas with 'swing' in order to meet seasonal demand—this gas was estimated to be able to 'swing' by 167 per cent.[60] It was therefore common for gas field facilities to be designed with swing in mind to meet the requirements of British Gas to deliver at peak times. Each joint venture was part of a network of other gas producing joint ventures that were connected by a complicated suite of special arrangements dealing with allocation, attribution and substitution that ensured gas quality and volumes were traced back to the relevant producing joint venture. These arrangements were not 'agreements' between the joint venture parties but included other parties such as the gas transporter, British Gas the buyer and other field owners using the processing facilities—as Peter Roberts notes in *Gas Sales and Gas Transportation: Principles and Practice* they are:

> arrangements for the sale of gas; arrangements for the transportation of that gas; and the accommodation of the gas sales and gas transportation arrangements within the wider context of the overall gas commercialisation project.[61]

Sales were delivered to British Gas in 'common stream' meaning no imbalances arose between the joint venture parties.

The complexities and many permutations that might be involved in gas commercialisation made it logical to develop bespoke arrangements, if and when, gas was discovered. The parking of negotiations relating to future development scenarios that might never eventuate is a common feature of the oil and gas industry and often results in commercial agreements lagging technical progress. *Taylor and Windsor* note that a number of other agreements, that are exclusively the purview of the parties, are likely to be needed in the course of an exploration and production venture 'as the venture

[59] The current 2008 UK model provides that offtake for both gas and oil will be 'agreements to agree' and to be in place prior to the commencement of production.

[60] M David, *Oil and Gas Infrastructure and Midstream Agreements* (Langham Legal Publishing 1999) 108.

[61] See P Roberts, *Gas Sales and Gas Transportation: Principles and Practice* (Sweet and Maxwell 2004) 13.

progresses'.[62] In *Oil and Gas: A Practical Handbook,* agreements dealing with lifting and disposal of gas and oil are identified as those in need of subsequent agreement, in particular agreement on the 'detailed provisions relating to over-lifting and under-lifting'.[63]

Deregulation of the UK's gas industry

With the multiple gas and condensate fields on the UK Continental Shelf (UKCS), the issues faced at 'Pohokura' are neither new nor complex. Restructuring from a joint gas sale mechanism to other mechanisms to balance gas offtake was grappled with in the UK in the late 1990s.

British Gas' monopsony purchasing position was removed in the eighties, allowing large users to compete to buy gas direct. In addition, significant volumes of gas dedicated under long-term gas sale agreements were released to other buyers. But it was not until the Competition Act 1998 came into force in March 2000, that joint gas sales had to be abandoned, creating competition among producers to secure buyers. Many queried how gas could be produced and delivered under separate sale contracts with different buyers who may call for disproportionate quantities on a day. The fear was that the unpredictable needs of customers would result in the disproportionate taking of production and consequential imbalances between each Party's right to its participating interest share of production and what it actually had taken.

Producer response—the appearance of 'aggregators' and the impact of the 'spot' market

At that time, most UK gas was sold under long-term contracts. The largest buyer was still British Gas (now Centrica), but since deregulation, other large users were also in the market—for example, Enron agreed to buy the 'J-Block' gas to power its new power station at Teeside, and Total agreed to buy the Trent field's gas to on sell to large industrial users.[64] These were 'take or pay' contracts that permitted the buyer to take up to a maximum annual quantity but guarantee that it would pay for a minimum quantity, usually between 80 per cent to 100 per cent of the annual quantity, whether it took the gas or not.[65] But the problem remained—if each joint venturer had its own gas sales contract with different daily requirements, how could the joint venture produce at efficient rates and ensure that each Party received its share of gas and oil when their various gas customers might take at different rates?

Some called for GBAs. A GBA is the gas version of 'borrow and loan' for oil and allows a Party to offtake more or less gas, in response to customer nominations, rather than proportionate to Participating Interest and 'bank' gas in the reservoir. Property accordingly vests in response to the nomination and not according to Participating Interest. Balancing is undertaken later in field life either in kind so that underlifters 'catch up'

62 Taylor and Winsor (n 48) xxiv.

63 G Picton-Turbervill (ed), *Oil and Gas: A Practical Handbook* (Globe Business Publishing Ltd 2009).

64 However, due to the success of the gas spot market, when these fields came on stream the price being paid under both was significantly higher for the buyers compared to the spot price. This resulted in litigation where Total successfully argued a condition precedent had not been satisfied. Enron was less successful and eventually settled with the J Block owners.

65 Similar to the take or pay contracts described as applying to Maui sales at para [325] High Court judgment.

before the field depletes or otherwise in cash by accounting for any overlifts at field depletion—essentially a GBA is a contractual framework giving effect to the common law principles laid out under the Statute of Westminster II and Statute of Anne.

Others suggested that if the work programme and budget approved by the Operating Committee contained a production schedule then as the schedule was binding on all Parties then the Operator was duty bound to produce as scheduled and, if necessary, rely on the various strands of the common law to justify the removal and sale of any untaken production.

In the Central North Sea where fields, like Pohokura, contain a mix of gas and liquids, maximizing revenues from gas sales were not the highest priority. Production relied on the extant oil nomination procedure and focused on maximizing oil/condensate sales. Gas produced as a consequence was sold to wholesalers, at the 'beach' (ie prior to entry into the national transmission system, the UK's Maui pipeline equivalent), under a delivery profile reflecting oil production. It was argued that these extant oil production provisions could be relied upon as a default if multi-party gas nominations to replace single buyer nominations could not be agreed. The emerging spot market also provided an option to sell any gas untaken on the day

UK balancing

In the end, a number of mechanisms emerged in the UK that involved a mix of selling to a primary customer and dealing with 'balancing gas' by sales to aggregators or on the spot market. GBAs proved elusive.[66] Esso, the UK subsidiary of Exxon, raised concerns that a GBA would breach the new competition legislation because it would be an agreement between competitors to manage supply. UKOOA sought a legal opinion on the validity of GBAs under the new legislation.[67]

The other larger companies who accounted for most UK production became active in the wholesale and/or gas trading markets and, being able to self-balance within their portfolios, did not need the flexibility a GBA brought. Some insisted on an inflexible regime in order to further their own commercial positions—the same position of being able to self-balance in which Todd found itself. Some larger Operators, Shell included, acted as aggregators. In particular, they obtained significant business in acquiring all the 'by-product' gas from the Central North Sea oil fields and aggregated the volumes at the 'beach' with a price calculated as a net back to the prevailing spot price. The added volumes gave them economies of scale when processed in their facilities and was used as feedstock for their petro-chemical plants, power generation or spot sales. Single buyers or buyer groups, such as Shell and Esso, might buy all of a field's gas producible on a day ensuring proportionate deliveries leaving each field owner to separately negotiate price. Gas was either sold on a put basis leaving the buyer to find its own flexibility or, where sold on a 'call' basis, any untaken volumes could be sold to aggregators or on the spot market. By the time the new competition law legislation took effect, the success of the UK

66 At least across the portfolio in which the author worked.

67 While a copy of the opinion is not available the key competition issues are dealt with in '*Joint Activities Among Gas Producers: The Competition Law Man* Cometh' (1998) 16(3) J Energy & Nat Res L.

spot gas market and the interconnection to the European network meant that each producer could always sell any gas not called for by its primary customer. For a period, the spot price was significantly less than the price British Gas (and others) paid under older, longer term contracts. In some cases litigation resulted (for J-Block and Trent). British Gas, which was still contracted to buy expensive gas under its legacy depletion contracts, declared *force majeure* whenever it could to reduce its buyer commitments but ultimately it negotiated a conclusion to most of the legacy contracts and significant gas volumes were released onto the spot market. Balancing under a GBA became moot.

8. Application to Pohokura

Production rates—the collective exercise of rights under a profit à prendre

Where a JOA includes a supervisory Operating Committee structure, it will typically be empowered to determine production rates as being within the scope of supervising 'Joint Operations'. The UK experience suggests that the Operating Committee's powers in this regard are largely unfettered unless conflict of interest language is included. On this, Todd's primary claim, the decisions of the New Zealand Courts accord with industry practice.

However, it is unclear how the Pohokura Operator delivered a 'firm production schedule' for the following year under the work programme and budget without specifying the firm volumes for delivery each day. The schedule itself could be sufficient to 'operationalise' the JOA as it would detail the daily production volumes and would dovetail with the estimates the Operator must provide for oil under Article 10.2. With Todd arguing that the Operating Committee had no role in determining production rates, it asserted that the projected production schedule was not a matter for consideration and approval but a statement of fact derived by the plant capacity less planned outages. Once the Court found to the contrary, the opportunity to question the validity of the production schedule that was actually delivered was lost.

Offtake rules—taking the benefits arising from a profit à prendre

Todd contended that the Operator may only submit matters for a vote that fall within the definition of 'Joint Operations' the inference being that matters outside the scope of the Joint Operations are not able to be properly considered and decided by the Operating Committee. This point appears undisputed but, in the context of Todd's claim for maximum production, the Courts held that the determination of annual production rates fell within the definition of 'Joint Operations' and so the validity of a proposal that was outwith Joint Operations was not considered.

While the AIPN made an effort to produce a model form JOA that was evenly balanced between Operator and non-operators, and so included the Operating Committee structure from BNOC, it was always understood to be a supervisor of the Operator.[68] It was never intended to control the activities of the non-operators themselves—it would be

[68] See Taylor and Winsor (n 48) xxiii, where the authors set out the two 'main' functions of the JOA, including the supervision of the operator by the operating committee in the conduct of operations under the licence.

unacceptable as a matter of corporate policy to allow a committee of competitors a broad discretion to regulate a Party's conduct. The express obligations of the non-operators applying to production in the JOA are limited to paying cash calls and lifting the share of available production neither of which are 'Joint Operations'. Like the AIPN Model Form, the Pohokura JOA defines 'Joint Operations' as those operations and activities carried out *by the Operator*[69] and so supervision thereof, or policies and procedures in relation thereto, are limited in application to the activities of the *Operator*—put simply, the Operating Committee supervises *Joint Operations*—non-operators do not conduct *Joint Operations*. It is therefore submitted that the Operating Committee has no power to impose new obligations on the Parties to make daily gas nominations to the Operator, in a prescribed form, with serious repercussions should a Party fail to comply. It can only impose obligations on the Operator. The imposition of new rights and obligations on to the Parties would amount to an amendment to the JOA which, the Court of Appeal observed,[70] is expressly outside the Operating Committee's jurisdiction and therefore would need unanimity. In particular, the rules allow a Party to lift a share of production that might be more or less than its Participating Interest share that vests when produced. Doing so amends the JOA and violates the applicable common law property rights. Even in the UK, where Operating Committees routinely approve production at rates below the maximum, each Party must still take its share as it is produced every minute of every hour of every day. It is up to each Party to resolve the practical implications of this 'inflexible' approach by making adequate arrangements downstream of the delivery point. To the extent, the owners believe that alternative means of lifting production would lead to the better exploitation of the field, for example lifting disproportionately to sell gas with 'swing', then they may agree to 'borrow and loan' to each other but they must do so unanimously—any other approach would violate the property rights of each Party to gas and oil that will have vested firstly in the joint venture, in New Zealand by virtue of the CMA, and secondly in each Party under the JOA.

The High Court considered that this 'inflexible' approach might lead to inequitable outcomes particularly where the failure to take was not the fault of the relevant Party. This analysis was partly driven by Todd's insistence that each Party must lift its share produced by the plant running at maximum capacity—240 TJ/d, every day—increasing the potential that a Party may not be able to absorb all gas within its portfolio. It is not clear whether the Court may have thought differently had Todd conceded that production may be set by the Operating Committee. It is also not clear whether the application of *force majeure* could assist to eliminate any inequitable outcomes. The Model Form provides that in the event of circumstances arising beyond a Party's reasonable control that frustrate a Party from performing its obligations (*force majeure*):

> the obligations of the Party giving such notice [of force majeure], so far as and to the extent that the obligations are affected by such Force Majeure, shall be suspended

[69] See para [92] of the Court of Appeal judgment.
[70] See fn 44 of the Court of Appeal judgment.

during the continuance of any inability so caused and for such reasonable period thereafter as may be necessary for the Party to put itself in the same position that it occupied prior to the Force Majeure, but for no longer period.

The *force majeure* provisions do not apply to the failure to pay cash calls and so, for non-operator Parties, can only apply to a failure to take a share of available production that arises through circumstances outside of their control. The effect would be to eliminate any inequitable outcomes by holding the non-lifting Party whole from its breach of its obligation to take its share and, potentially, allow it to 'catch up' in a subsequent period.

Accordingly, the 'share' of production that must be taken is the oil and gas that has been produced according to the approved work programme and vested in the Parties in proportionate, undivided interests, at the wellhead. The obligation to take this share cannot be 'read down' any more than it can be accelerated. A proposed work programme and budget premised on offtake in a potentially, disproportionate manner would not meet the criteria to be a 'Joint Operation' and would be consequentially outside the power of the Operating Committee to determine.

Most of these steps were recognized by the Court of Appeal.[71] But in regards to quantities for offtake it noted Todd's claim that applying the principles for oil offtake would deliver gas but did not address the practical implications of that before dismissing the relevance of those principles as not furthering Todd's claim to maximum rates. Instead the Court held it did not matter whether the principles for oil offtake were applied 'because the effect of the offtake rules and the nomination protocols is to impose a regime which in all material respects is of a similar nature to what would have been applicable had an offtake agreement in fact been executed under art 10.2'.[72] With respect this ignores the point that the principles were already binding and effective. They were also materially different to the Offtake Rules as they centred on the Operator telling the Parties how much production was available, not the Parties calling for it, and required each Party to take its full share of production with 'sale options' applying if they did not. An offtake agreement could not be similar to the Offtake Rules and incorporate the principles for oil offtake.

The effect of a failure to lift a share of gas is a reduction in associated oil production, affecting all Parties. If a Party fails to take its share in circumstances where *force majeure* relief was not available, then several consequences arise:

1. The provisions of art 9.2(H) of the Model Form would activate a 'sale option' enabling the Operator to lift the untaken production, sell it and account to the non-lifting Party for the proceeds, less costs and any agreed marketing fee;
2. Failing a 'sale option' the non-lifting Party will be in breach of its contract of bailment and will be wrongfully storing its production in the joint facilities. The

71 Para [134] Court of Appeal.
72 Para [139] Court of Appeal.

Operator becomes an 'involuntary bailee' with a duty to act reasonably in all the circumstances, which it is submitted, includes the prospect of removing untaken production to prevent production curtailment, selling it and accounting to the owner;

3. If production is not removed the facilities will either become dangerously unstable, (perhaps triggering the right of a 'carrier' to dispose of untaken goods that have become hazardous under the Common Carriage Act 1979) or the Operator will have to curtail production resulting in the non-lifting Party being in breach of the JOA and guilty of trespass to land by excluding its fellow tenants in common from the use and enjoyment of their share of the profit à prendre and plant;
4. The production schedule approved by the Operating Committee is binding on all the Parties and the Operator is duty bound to produce to it. Altering the schedule, other than for emergency reasons, will need a derogation from the Operating Committee;
5. Any reduction in production will have a consequential negative financial effect on the lifting parties and disrupt any downstream gas or oil arrangements that may have been arranged, giving rise to a damages claim and the obligation to mitigate. As such a derogation from the Operating Committee is unlikely to be forthcoming unless other options are fully explored. For example, the Operator, acting reasonably, could procure the removal of the untaken production and its sale pursuant to common law or statutory justifications.
6. Whilst disposal of another Party's production could constitute a conversion of its property a further answer to such a claim is that the lifting Party was mitigating its damages arising from the failure to lift its share and the ouster of the lifting Parties from use of the facilities. McGregor on Damages[73] states:

   > (3) The third rule is that, where the claimant does take steps to mitigate the loss to him consequent upon the defendant's wrong and these steps are successful, the defendant is entitled to the benefit accruing from the claimant's action and is liable only for the loss as lessened; . . ..

7. In the context of a failure to lift, selling a non-lifter's production could be justified if it mitigates damages that would otherwise arise if production was curtailed provided any residual benefits that accrue, over and above the avoided damages, are accounted for to the non-lifting Party.

These consequences must be contrasted with a failure to lift in circumstances amounting to *force majeure*. Then the equities favour the non-lifter and the Parties must act to put the non-lifter back in the position it was in prior to the event giving rise to *force majeure*. How the Parties might do that would need to be fleshed out in the circumstances but would clearly need to ensure that underlifted volumes are made available for lifting at

73 *H McGregor, McGregor on Damages* (19th edn, Sweet & Maxwell 2014).

a later time or a cash settlement is made if those volumes were overlifted and sold by another Party.

Lifting disproportionately because downstream sale contracts provide for swing would not ordinarily constitute *force majeure*. However, the Offtake Rules treat all failures to take proportionately as being subject to a *force majeure* like provision. They replace the property rights determined under the JOA, and underlying common law, with a process by which the Parties might take more or less than their share and if an underlift arises, balance in kind in a later period. Under the rules production occurs in response to a daily nomination, not the firm production schedule. It is the nomination that defines the quantity of gas that will vest in each Party and not the share determined by each Party's Participating Interest. The High Court's finding that flexibility must have been intended addresses the inequitable outcomes that might arise through proportionate lifting but the ruling effectively eliminates the obligation entirely.

Oil nominations

The High Court was energised to validate the Offtake Rules as they filled what it considered was a gap in the JOA—that is that without a nomination process in place then some form of procedure would be necessary and desirable to 'operationalise' the JOA. In the Court of Appeal, Todd pointed out that the oil nomination process, which all agreed was binding and effective, was the default mechanism by which production was determined and delivered and would fill any 'gap' in the absence of gas offtake arrangements. With gas being produced in association with oil, Pohokura, like most Central North Sea fields, could be produced using the agreed oil nomination and lifting principles with associated gas being lifted proportionately. In fact, Todd argued, the Offtake Rules effectively displaced the binding principles for oil offtake, amending the JOA, and so would need unanimity. The Court of Appeal[74] dismissed the relevance of the principles for oil offtake as not furthering Todd's claim to production at maximum rates because oil production rates would still need to be determined by the Operating Committee. The Court did not address why Article 10.2 or 10.3 would be needed at all if the Operating Committee could impose procedures for offtake as a 'Joint Operation' nor did it address how the oil nomination and lifting procedure could operate as intended in parallel with a competing regime dealing with gas nominations that in practice produced oil.

9. Conclusion—New Zealand is not Kansas

The case deals with when an agreed contractual structure displaces the common law in regards to exercising the right to extract under a profit à prendre and the distribution of resulting benefits. The case affirms that at Pohokura the exercise of extraction rights held collectively under a shared profit à prendre is subject to the Operating Committee's powers. The approach of the New Zealand Courts to the determination of the production rate is in line with industry practice. However the validation of the Offtake Rules, as a

[74] Para [139] Court of Appeal.

new mechanism by which production vests and is distributed, is a surprising outcome and must be viewed in the narrow context of Todd's primary claim.

Former AIPN president, Jim Barnes, said:

> The biggest problem with international law and what we do is that everything changes every time you change countries. It's intuitively obvious, but you'd be surprised by how many people get caught up and make the mistake of thinking, making the assumption, that it's just like it was in Kansas.
> And it's not.[75]

By conceding that the obligation to lift a share might be 'read down' across the life of the field, Todd effectively agreed that production might vest in nominated shares, as prescribed by the Offtake Rules, and not proportionate to Participating Interests at the wellhead. The only question to be answered by the Courts was who decides how much should be produced. Todd contended that the Operating Committee had no role and that the decision was determined on plant capacity. This argument might find support in the USA where the JOA is just as likely to not have an Operating Committee and 'maximum efficient rates' might prevail. With a 'minority view' type of approach, Todd could balance by accounting for overlifts. But the differences in JOA governance, ownership in the petroleum estate, the interventions by the regulators and resultant industry practices make the application of US common law in New Zealand unclear—New Zealand is not Kansas or, as they say here in New Zealand, 'you're not in Guatemala now, Dr Ropata'.[76] The Courts' decision on that primary issue appears to have determined the overall equities between the Parties as both Courts were prepared to overlay a practical gloss on the production sharing arrangements to 'operationalise' the JOA.

However, it was open to the Courts to acknowledge the power of the Operating Committee to set production rates while enforcing the requirement of each Party to lift its proportionate share. The practical effect would be the inability to sell gas with 'swing' without balancing arrangements being in place. While it might be argued that this would result in a sub-optimal exploitation of the field an equally compelling response would be that production at maximum efficient rates would bring with it accelerated production revenues that would be a significant source of cash flow and royalty return to the Government. Ultimately, the commercial dynamics of a gas and oil field will vary over time depending on prevailing gas and oil prices. Oil in particular has spiked well above $100 per barrel since Pohokura's project sanction in 2004. Commodity prices cannot be determinative of how a contract agreed before anything was discovered should be interpreted. The JOA provides for oil nominations, oil is produced at Pohokura, in the absence of amendment the Parties are therefore entitled and obliged to rely on them even if doing so would, in the opinion of some, be sub-optimal for gas. If they would rather

[75] From the AIPN's *The Art of the DeaI – The Story of the AIPN*, 5.

[76] This is a line from New Zealand's soap opera, Shortland Street, which is used to describe being in a new situation or place that is different to what has been the previous experience.

develop the field as a 'gas' field and sell with swing then they will need to modify the JOA. This process was commenced in the context of joint sales but was not completed because agreement could not be landed. The oil nomination provisions remain effective.

An approach that conceded that the Operating Committee was empowered to determine production rates but that each Party was required to take their share of production, proportionate to Participating Interests, would align with UK practice and could be supported with reference to rights prescribed in the JOA and underpinned by common law principles that have been applied in New Zealand. But such an outcome does not guarantee production at maximum rates. In the absence of conflict of interest rules, the Operating Committee could set production at rates below the maximum for their own commercial reasons. However, the effect of enforcing the taking of production proportionately would be the elimination of 'swing' sales. In that context, it would be unlikely that the Operating Committee would set production at lower rates. To accommodate Shell and OMV's swing contracts, a GBA would need to be concluded or production would need to be set at the highest rate their customers could call for on a day and other arrangements, such as those that emerged in the UK, would need to be made downstream of the delivery point to ensure gas not called by their primary customers was taken by someone else. Those arrangements, that included the use of the emerging spot gas market, provided long-term benefits for gas consumers in the UK and encouraged further exploration. Indeed New Zealand has a fledgling spot market for gas that would welcome additional volumes.

The conclusion on Todd's primary claim to maximum production rates reflects the mechanisms in the JOA that regulate how and to what extent the jointly held profit à prendre would be utilized, overtaking common law principles and aligning with industry practice. With Todd relying on US common law to determine balancing that the Court of Appeal dismissed as uncertain in its application in New Zealand, an opportunity was missed to grapple with the principles of common law applicable in New Zealand to the disproportionate use and enjoyment by co-tenants of an estate in land. The applicable law has developed in New Zealand from the Statute of Westminster II, that reflected Todd's submission that it would have to cease taking until the other co-tenants 'caught up', thereby balancing in kind, and the Statute of Anne that would require an accounting for profits from overlifts, thereby effecting cash balancing.

However, with the High Court determining that proportionate offtake would lead to inequitable outcomes the enforcement of the proportionate sharing rule, under the JOA and underlying common law, was not advanced in the Court of Appeal with any rigour and so the validity of the right to lift disproportionately set out in the Offtake Rules was not fully explored. The Court was satisfied that the Operating Committee could determine production rates and develop rules by which the Operator could produce to match gas customer demand. It glossed over the fact that the same Offtake Rules placed a new obligation on each of the Parties to make gas nominations and new rights to lift disproportionately and balance in kind. These rules were given contractual effect thereby displacing how the common law applicable in New Zealand would determine the rights of the Parties in respect to imbalances. In all, the decision reflects a practical outcome that is reminiscent of the principle of 'majority rules'. But New Zealand 'is not Kansas'. With respect, there is no applicable principle of 'majority rules' under New Zealand law that would allow the majority to interfere with gas owned by a Party without the affected Party's consent, no matter how commercially pragmatic such a proposition might be.