INTERNATIONAL LAND CONTRACTS

COVENANTS NOT TO COMPETE
AMIs, PREFERENTIAL RIGHTS, RIGHT OF FIRST REFUSAL
INDEMNITY CLAUSES
STABILITY CLAUSES

DESCRIPTION
BENEFITS/DETRIMENTS
ENFORCEMENT/REMEDIES
PRO-FORMA CLAUSES

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SUMMARY

Discussion paper with example paragraphs of common terms used in international oil and gas agreements.

Four terms are assessed:

- Covenants not to compete
- AMIS, Preferential Rights, Right of First Refusal
- Indemnity Clauses
- Stability Clauses

The discussion includes:

- A description of the term and when it is used.
- Benefits and detriments associated with the term.
- Enforcement and remedies of the terms.
- Pro-Forma example clauses included in the discussion paper

COVENANTS NOT TO COMPETE

Description of the issue:

Covenants not to compete (*anti-competitive agreements)* generally deal with one party agreeing with another party (a contractual promise) not to compete in a certain way with the other party in a certain business activity or agree not to be employed (a *non-poaching agreement*) in a certain competitive business activity.

Contract commercial clauses dealing with covenants not to compete are sometimes inserted (in regard to the oil and gas industry) in Confidentiality Agreements, Farmout Agreements, Purchase and Sales Agreements and other land related commercial agreements. Since land and access to land are critical components in the mineral resource business, parties who invest in such resources (and associated land) are sensitive to optimizing their competitive advantage and protection of their assets.

Purpose for the Covenant

Benefits

Some of the key commercial drivers for promoting the use of a covenant not to compete include protection of legitimate business interests or, proprietary interests entitled to protection, typically associated with:

- A company's Goodwill
- Trade secrets
- Confidential information

Detriments

Unlike times past in which society was predominately agrarian and businesses and employees were generally immobile, today's business and employees are highly mobile.

Due much to this increased mobility, and as a general rule, the law and commercial business objectives tend to 'disfavor' non-compete restrictions, because of society's preferences of:

(i) Employees being free to make the best possible bargain for their labor;
(ii) The public's interest in maximizing available services; and
(iii) The public benefiting from competition by letting the competitive market place determine prices.

Enforcement/Remedies of the Covenant

Generally, to enforce a covenant not to compete, the covenant must be 'reasonable' –

- From the standpoint of the party in whom the covenant is applicable, is it reasonable in the sense that it is not greater than is necessary to protect that party in its legitimate business interest?; and
- From the stand point of the other party (the employee or restricted party), is the restraint reasonable in the sense that it is not unduly harsh and oppressive in curtailing their legitimate efforts to earn a livelihood?; and
- Is it reasonable in the context of sound public policy?

What is reasonable will vary from case to case and the specifics of any one circumstance, but is generally determined by assessing the following characteristics of a covenant not to compete clause… Is it…

- In writing?
- Part of a contract of employment or ancillary to part of an otherwise enforceable agreement at the time it was made or other legitimate business interest?;
- Based on valuable consideration?;
- Reasonable as to duration in time and territory (geographic scope) it applies?;
- Fair to all the parties involved and not unduly burdensome on an employee's right to earn a living (is the kind of activity being protected legitimate interests for all parties?);
- Not against public policy?

If noncompetition agreements are deemed to be enforceable, and if reasonable when first originally written, they generally are enforced on an "all-or-nothing" approach. However, there have been some (the minority view) liberal interpretations of covenants not to compete by the enforcing body separating and enforcing certain 'reasonable' portions and striking other 'unreasonable' portions, the so called 'blue pencil' rule.

Some jurisdictions have statutes governing non-compete agreements and should be consulted if that jurisdictions law will govern a commercial agreement.

Enforcement of covenant's not to compete if breached by the restricted party can include injunctive relief (inclusive of specific performance) or money damages.

<u>Pro-Forma Covenant Clauses</u>

While it is difficult to draft an absolute 'bullet proof' covenant not to compete clause (because of the breadth of a reasonableness interpretation), the terms of such drafting should be tested against the above cited reasonableness test, and be comprehensive and clear in expressing the parties intentions, and as necessary, counsel confirming the extent of any applicable statute.

Example covenant not to compete clauses:

Clause 1 (non-poaching)
The Disclosing Party will designate specific company representatives(s) ("Company Representatives") for the purpose of providing to or discussing Confidential Information with the

Receiving Party. Except with the prior written consent of the Disclosing Party, none of the Receiving Party and those parties to whom the Confidential Information has been disclosed pursuant to Paragraphs 4 and 5 hereof:

8a will communicate except with the designated Company Representatives for the purposes of dealing with Confidential Information and discussing the terms of a possible transaction, and

8b will, for a period of two years from the date of this letter, directly or indirectly knowingly solicit or cause to be solicited the employment of any person who is at the date of this letter employed by the Disclosing Party or its Affiliated Companies except as a result of such person responding to a bona fide public domain or privately organized (e.g. by an employment agency) advertising campaign.

9 The Receiving Party acknowledges that the securities of the Disclosing Party are traded on the London Stock Exchange and that some or all of the Confidential Information may be price-sensitive. Accordingly, the Receiving Party undertakes that it shall not knowingly, for itself or for others, within a period of 12 months from the date of this Agreement, deal in the securities of the Disclosing Party.

Clause 2 (non-poaching or non-solicitation)
The Receiving Party shall not, without the prior written consent of the Disclosing Party, for a period of twelve (12) months from the date hereof, directly or indirectly solicit for employment any employees of the Disclosing Party or any of its Affiliates or induce or attempt to induce any employees of the Disclosing Party or any of its Affiliates to leave their employment. The prohibition on solicitation and inducement contained in this paragraph does not extend to (i) general solicitations of employment by the Receiving Party not specifically directed towards the employees of the Disclosing Party nor to hiring the Disclosing Party's employees as a result thereof or (ii) hiring of Disclosing Party's employees as a result of such employee independently on its own seeking employment with Receiving Party. For the purposes of this Section 0, an individual is considered an employee of the Disclosing Party or its Affiliate if such individual is, at the time of solicitation or hire, an employee of the Disclosing Party or any of its Affiliates.

Clause 3 (standstill or covenant not to acquire stock)
1.1 The Receiving Party represents and warrants that as of the date hereof **[neither the Receiving Party nor any of its Affiliates beneficially owns (as defined in Part XX of the *Securities Act* (Ontario)) any Common Shares or other securities of the Disclosing Party / the Receiving Party together with its Affiliates beneficially owns (as defined in Part XX of the *Securities Act* (Ontario)) ■ Common Shares and no other securities of the Disclosing Party]**. The Receiving Party covenants and agrees that, for a period of twelve (12) months from the date of this Agreement, (i) the Receiving Party shall not, (ii) none of the Receiving Party's Affiliates shall, (iii) the Receiving Party shall not permit any of its Affiliates to, (iv) neither the Receiving

Party nor any of its Affiliates shall assist or encourage any of its Representatives to, in each case, directly or indirectly, alone or acting jointly or in concert with any other Person:

(a) acquire or agree to acquire, or make any proposal or offer to acquire, directly or indirectly or in any manner whatsoever, any securities of the Disclosing Party or any of its Affiliates;

(b) solicit proxies from shareholders or other security holders of the Disclosing Party or any of its Affiliates or otherwise attempt to advise or influence the conduct of the shareholders or other security holders of the Disclosing Party or any of its Affiliates;

(c) solicit, initiate or engage in any discussions or negotiations regarding, or enter into any agreement, commitment or understanding regarding, or otherwise act jointly or in concert with any Person in order to propose or effect, any take-over bid, tender or exchange offer, amalgamation, merger, arrangement or other business combination or similar transaction involving the Disclosing Party or any of its Affiliates or in order to propose or effect any other acquisition of securities or assets of the Disclosing Party or any of its Affiliates;

(d) in any manner directly or indirectly seek to control or influence the board of directors of the Disclosing Party or any of its Affiliates or the management or policies of the Disclosing Party or any of its Affiliates or to acquire effective control of the Disclosing Party or any of its Affiliates;

(e) make any public disclosure of any consideration, desire, intention, plan or arrangement in connection with any of the foregoing; or

(f) advise, assist, encourage or negotiate with any other Person to do any of the foregoing, including, without limitation, by providing financing for such purpose,

in each case except with the prior written consent of the Disclosing Party (which consent may be withheld in the Disclosing Party's sole discretion).

1.2 Notwithstanding Section 1.1 above, the limitations and prohibitions set forth in Section 1.1 shall cease to apply and nothing in this Agreement shall prevent or restrict the Receiving Party or its Affiliates from engaging in any of the activities outlined in Section 1.1 above if and only if the Disclosing Party makes a public announcement that it has: (A) agreed to a merger, amalgamation, arrangement or direct or indirect sale of all or substantially all of its assets or similar transaction with or to a Person (other than any of the Persons who are restricted in accordance with Section 1.1, any of such restricted Person's Affiliates or any Person acting jointly or in concert with them (a "Third Party")) which, if the transaction is successfully completed, will result in the shareholders of the Disclosing Party holding less than 50% of the voting securities of the resulting corporation or entity (or its parent corporation or entity, if the resulting corporation or entity is to be a wholly owned subsidiary of another corporation or entity after successful completion of the transaction); or (B) entered into an agreement with a Third Party pursuant to which the Disclosing Party has

agreed to support and recommend a take-over bid for the Common Shares of the Disclosing Party by such Third Party (or an Affiliate of such Third Party).

Notwithstanding anything in Section 1.1, the Receiving Party shall be permitted to make a confidential proposal (a "Proposal") to the board of directors of the Disclosing Party regarding any of the transactions or activities contemplated in paragraph (a) or (c) of Section 1.1, to enter into discussions or negotiations with the board of directors of the Disclosing Party or with one or more individuals designated by the board of directors for such purpose with respect to the terms of any such Proposal and to enter into any agreement with the Disclosing Party providing for the consummation of such Proposal; provided that the Receiving Party shall not under any circumstances make any public disclosure of the making of or terms of such Proposal or agreement except with the prior written consent of the Disclosing Party, which consent may be withheld by the Disclosing Party in its sole discretion.

AREA OF MUTUAL INTEREST, PREFERNETIAL RIGHT TO PURCHASE, RIGHT OF FIRST REFUSAL

Description of the issue:

Restrictions on acquisition and alienation of property found in oil and gas agreements include areas of mutual interest, preferential right of purchase and right of first refusal.

Areas of Mutual Interest…(or "AMI") is an agreement among two or more parties in which the parties agree to cooperate with one another on predefined terms for each to retain an option to jointly share (typically based on then existing proportional ownership interests) in the future rights and obligations associated with certain described areas of land in which one or more of the parties desire to capture (onshore or offshore) whereby such parties generally do not have an existing property right in the AMI lands when the AMI is established. The AMI lands are usually associated with the party's business desire to jointly progress oil and gas exploration and production activities the AMI lands. AMI lands contiguous to existing property rights or may extend above and below the area of existing land rights in anticipation of future acquisitions or unitizations.

Preferential Right of Purchase…(or "Pref Right", and sometimes referred to as right of first refusal, preemptive right or first option) is an agreement among two or more parties in which some of the parties are described as 'transferring parties' and the rest of the parties described as 'non-transferring parties', in which the non-transferring party is granted the power to preempt a future 'sale' of a property or property right by the transferring party, on which the Pref Right is burdened, to a third party by invoking the right and matching the purchase price (and matching any other term as may have been agreed between the transferring and non-transferring party in the Pref Right agreement).

Right of First Refusal…while a Right of First Refusal (or 'ROFR", sometimes referred to as a 'call option') is often synonymous with a Pref Right, for the purposes of this paper, a ROFR will be described as a special Pref Right, whereby the ROFR is an agreement among two or more parties in which some of the parties are described as 'transferring parties' and the rest of the parties described as 'non-transferring parties', in which the non-transferring party is granted an option prior to the transferring party 'selling' of a property or land right, on which the ROFR is burdened, to a third party, by the non-transferring party invoking the first right after notice from the transferring party and offering a purchase price and other terms for purchase of the property. The transferring party has the option of either accepting such offer, or rejecting the offer and offering the property to a third party on terms no less attractive than what the non-transferring party offered. If a third party offers less attractive terms, the transferring party must first re-offer the property back to the non-transferring party (in effect a Pref Right) on the same terms and the non-transferring property having an option but not an obligation to accept such terms and if not accepted, the transferring party can progress the sale with the third party on those terms.

AMIs, Pref Rights or ROFR, while generally are separate unique legal and restrictive commercial rights to acquire property, have three common themes:

1. Each restrictive commercial right creates in their own separate mechanisms, restrictions on the right of a transferring party to freely transfer (or acquire) some or all of its rights and interests in property (generally in real estate, onshore of offshore) to a third party;
2. The restrictive commercial right cannot be unilaterally enforced by the non-transferring party prior to, and without the transferring party to whom the right burdens, initiating an activity or course of conduct that causes the right to mature (a future right that arises as a consequence of a condition subsequent); and
3. Once the restrictive commercial right matures, the non-transferring party has the option but not the obligation, to exercise its rights associated with the restrictive commercial right.

Contract commercial clauses dealing with Areas of Mutual Interest, Preferential Right to Purchase (or Right of First Refusal) are sometimes inserted (in regard to the oil and gas industry) in Confidentiality Agreements, Farmout Agreements, Joint Operating Agreements, Purchase and Sales Agreements and other land related commercial agreements. Since land and access to land are critical components in the mineral resource business, parties who invest in such resources (and associated land) are sensitive to optimizing their competitive advantage and protection of their assets.

Benefits

AMI

The primary purpose of an AMI is to afford those parties who are mutually taking risks and jointly funding the exploration and development of a contract area, jointly share and proportionally the benefits of these activities, and promote cooperative behavior among the parties to the AMI in regard to shared development of competitive advantaged information, pooling of developed skills or unique knowledge concerning access to commercially attractive lands that complement existing operations. AMI cooperation results in the sharing of business risk and reduce the cost of operations since the parties are no longer rushed to purchase leases and the attempt to unilaterally gain a competitive edge.

Pref Right.

Pref. Rights gives the holder the opportunity and option, although a contingent one, to acquire future valuable interests in the burdened property. The provision provides the holder some control over with whom he conducts oil and gas operations pursuant to his interest in the joint operating agreement (option to pre-empt the introduction of an undesirable third party – because of economical risk or liability reasons - as a co-owner in the operation whose interests may not be aligned with the parties). The right reinforces uniformity to the operation and development of the parties' venture, insures administrative efficiency and continuity of the overall design of the operations.

ROFR

Similar benefits as the Pref. Right.

Detriments

AMI

An AMI tends to lock in future partners in regard to newly acquired lands and the original cooperation or alignment of the original partners could in the future be misaligned, thereby causing creation of an unwanted or awkward partnership and/or restriction on an otherwise unilateral right to acquire interests in AMI lands.

Pref. Right. And ROFR (FYI: Pref. Rights are the most litigated area involving JOAs per Thomson and Knight law firm)

Pref. Rights have the characteristic of reducing, impairing and 'chilling' the marketability of a property interest because of the concern from potential third party buyers of spending the time and money to establish a market value of the property on which the Pref. Right burdens, only to have a non-transferring party having full access to such valuation information and option to pre-empt a sale on those terms.

Some jurisdictions (UK for example) have statutes that prohibit preferential rights of purchase based on the concern that such pre-emption clauses are a major unreasonable impediment to competitive commercial activities and against public policy and there being legitimate reasons for wanting to promote unrestricted divestment objectives (such as, rationalize non-core/small asset interests; avoid high cost operations; avoid decommissioning costs; time to capitalize a particular asset; interest may economical to a smaller company; prioritize capital to other assets).

Enforcement/Remedies of the AMI, Pref Right, and ROFR

General

AMIs, Pref. Rights and ROFRs by definition restrain the **free alienability** of the burdened property, and are technically agreements in restraint of trade. These restraints do interfere with the property holder's right to select to whom he wants to sell, and do discourage third party interest in the property because of the difficulties and restraints placed on sale. Consequently the general rules against restraint on alienation and against perpetuities embody judicial policy that agreements that unreasonably restrict free alienability of property are not enforceable. The doctrine of freedom of trade is hinged on public policy whereby the public interest is best served where parties to commercial transactions have the liberty to enter into legal relations without restrictions as to with whom, where and when such legal relations may be made. These polices promote full utilization and transferability of land and promotion of competitive prices in which the public benefits.

Nonetheless, these **restrictions are not unreasonable per se**. The generally accepted view is that the restraints placed by these provisions (provided they are reasonable) are indirect and ancillary to a legitimate purpose and recognition of legal justification exists or where it is in the public interest to impose such a restriction or restrictions. The facts and circumstances of each case must be carefully examined to assess the reasonableness test.

In some jurisdictions the **rule against perpetuities** at common law must be assessed. The rule generally requires that a party have a valid contingent interest in property that must vest in a specified length of time (usually within a lifetime). If an option or restrictive right has no time limit, judicial bodies generally will interpret the right to be valid for a reasonable period. However,

if the option or right is intended to be unlimited in duration, then it is void under the rule against perpetuities and unenforceable.

Generally, AMIs, Pref Rights and ROFR, being subject to the rules relating to real property are generally governed by the **statue of frauds**: The agreement must be in writing, signed by the parties bound by the terms in order to be effective and all blanks in the agreement filled and options selected.

Generally at common law, to enforce a restriction on land, the restriction should normally be **recordable** in some public forum so that all parties are on reasonable notice of the existence of the restriction. Notice is particularly of interest if a third party bona fide purchaser without notice of the restriction, purchases the burdened land and the transferring party then becomes either non-existent (liquidates) or bankrupt or otherwise financially unworthy. In this case, the non-transferring party could be exposed as to being unable to enforce its Pref. Right or ROFR rights. In many non-common law jurisdictions, there are not any well established public recordation or public places of notice in which all third parties, if notice had been timely and properly recorded (so called perfection of the notice), are deemed to be on notice of such restraint on land sales. A very real and practical problem. Procedures on how to establish notice of a restraint on land sales will vary but could include:

- Recordation of such restraint in joint operating meeting minutes and other administrative papers that a third party purchaser could be reasonably expected to inspect as part of a due diligence purchase process and then deemed to have actual knowledge of the restraint;
- Recitation of the restraint in material documents such as joint operating agreement, public financial disclosure documents, attachment as part of a title deed on record with a government body (although many times this level of detail is not desired to be housed in government title documents);
- Publication of memorandum or summary of restraint terms in third party commercial title document resources (such as Barrows, IHS, WoodMacKenzie; etc) or other readily industry recognizable resources that a third party purchaser would generally be expected to research in regard to due diligence analysis of the property

A key question is whether the land restriction is a '**covenant running with the land**' (attaches to the land and remains a burden and legally enforceable by and to any future successors or assigns regardless of any future transfers of the land) or whether the restriction is a mere '**personal covenant**' that only applies to the original parties to the restriction agreement. Drafting of the agreements should be clear whether such restrictions continue to attach to the land even if the land is subsequently transferred. Generally a covenant running with the land has the following characteristics:

- The original covenant must be enforceable (a legal enforceable right when created)
- The parties must intend that the covenant run with the land
- The covenant must touch and concern the land
- There must be privity of estate between the parties

<u>AMI</u>

Typical AMI terms requires the acquiring party to give notice to the other parties and the other parties having an option for an agreed amount of time to elect to participate in the acquisition and reimbursement to the optionee his share of acquisition costs. The offer becomes a bilateral contract of sale only when and if accepted by the optionee in the manner and with the time prescribed.

Pref Right. And ROFR

Factors often cited to determine if a Pref. Right or ROFR "unreasonably" restricts alienation, and therefore not enforceable, include:

- Whether the party imposing the restraint has an interest in the land he is seeking to protect by enforcement of the restraint;
- Whether the restraint is limited in doctrine;
- Whether the enforcement of the restraint accomplished a worthwhile purpose
- Whether the number of persons affected by this action is small
- The restraint is not injurious to the public interests

The Pref. Right is distinguishable from a pure option in that the holder of the right cannot unilaterally exercise his right until the owner of the burdened property triggers the option and decides to sell. And the option must be exercised against all the property burdened by the restraint and not just a portion unless the agreement or parties agree otherwise.

The terms of the Pref. Right need to be unambiguous and the parties intentions clearly stated. For example, many Pref. Rights cite only a 'sale' event as triggering the Pref Right. Consequently, what does 'sale' mean or include? Various potential property transfer events that may be intended to be included in the burden of the Pref. Right need to be clearly defined and described. For example, does the Pref. Right and the term 'sale' include:

- Non-sale activities, such as property swaps or exchanges; non-cash consideration
- Package transactions in which the burdened Pref. Right is part of the package (does the pre-empt option apply to the entire package or just the Pref. Right property)
- Assignments of overriding royalty rights or net profit interest rights
- Mortgage or judicial foreclosures including public transfers by administrators; transfer as a result of condemnation
- Acquisition of corporate stock transfers (via stock purchase, merger, acquisition, amalgamation) and are there any limits that might apply to the Pref. Right option (example, if the Pref. Right property is comprised of less than [ten percent (10%)] of a stock acquisition, merger or other corporate stock transfer, then the Pref. Right will apply the burdened property)
    - If stock transfers are involved, minority holder rights may be affected by 'Drag-Along Rights' (minority stockholder is obligated to participate in the majority stock transfer decision) or 'Tag-Along-Rights' (minority stock holders can force the majority stockholders to include the minority shares in the affected stock transfer).
    - Are Drag Along or Tag Along rights affected by restraints on property transfer?
- Gifts, donations and transfers resulting from the death of the owner either by Will or intestate succession
- Intra-company transfers (of assets or stock)

- Forced unitization (or pooling)

A comprehensive form definition of 'sale' might be structured as follows:

"The definition of "sale" means the intentional or unintentional transfer of any Transferring Party's interest in the Transferred Property and shall include but not be limited to:

- *a transfer of interest in which the consideration for the transfer is cash or cash equivalent such as marketable financial instruments such as bonds, bullion, certificate of deposits or other marketable assets in which the party's to the transferring transaction place value;*
- *a transfer of interest in which the consideration for the transfer is non-cash such as exchange or swap of property rights;*
- *transfer of a package sale in which the Transferred Property is part of the package sale provided the fair market value attributed to the Transferred Property is greater than [ten percent (10%)] of the aggregate fair market value of the package sale assets; and in the event the Transferred Property fair market value is greater than [ten percent (10%)], the Non-Transferring Party Preferential Purchase Right option shall apply to [only the Transferred Property/the entire package sale];*
- *assignment or other transfer of any passive interest including but not limited to over-riding royalty interest, net profit interest or any other passive interest;*
- *a transfer resulting as a consequence of the Transferring Party's unintentional event including but not limited to: a judicial sale or transfer, mortgage foreclosure, public transfer by government administrators, transfers resulting as a consequence of condemnation, imminent domain or other similar proceeding;*
- *transfers arising as a consequence of gifting, donation;*
- *transfers arising as a consequence of inheritance rights arising either by testate (by Will) or intestate succession;*
- *transfer arising from voluntary or involuntary unitization or pooling;*
- *transfer arising either directly or indirectly as a consequence of acquisition of corporate stock transfers (via stock purchase, merger, acquisition, amalgamation, or other property transfer arising as a consequence of security dealings), provided the fair market value attributed to the stock associated with the Transferred Property is greater than [ten percent (10%)] of the aggregate fair market value of the aggregate fair market value of the stock being transferred; and in the event the Transferred Property attributed fair market stock value is greater than [ten percent (10%)], the Non-Transferring Party Preferential Purchase Right option shall apply to [only the Transferred Property stock/the aggregate stock value of the total stock transaction]. Stock transfers shall include stock transfers associated with minority holder rights, generally described in the trade as 'Drag-Along Rights' (minority stockholder is obligated to participate in the majority stock transfer decision) or 'Tag-Along-Rights' (minority stock holders can force the majority stockholders to include the minority shares in the affected stock transfer)."*

Enforcement of restrictions can generally be by way of specific performance, injunctive relief or damages (except for ROFR, the usual remedy is limited to only damages). Generally the burden is on the party enforcing the restraint to demonstrate it is reasonable. If a party's position that the restraint imposed by the covenant is contrary to public policy (where such policy takes into account

both the transferring and non-transferring party interests), the burden is on the party challenging the restraint, usually the defendant or respondent (transferring party).

A party who has the option, must timely exercise its rights, else that party can lose such right by way of actual or implied waiver/laches (inexcusable delays that others have relied on to their detriment that causes the non-transferring party to lose its rights) or estoppels (a party's conduct and length of time of an untimely unexercised option, in which the transferring party has relied to its detriment, can cause the non-transferring party to lose its option right).

<u>Pro-Forma AMI, Pref Right and ROFR Clauses</u>

Example AMI clauses:

The Receiving Party acknowledges that the Disclosing Party will acquire valuable and proprietary knowledge of information surrounding and within the Area and for such purposes agrees that for a period of two (2) years from the date of this Agreement, if the Receiving Party or its Affiliated Companies acquires an interest within the area of mutual interest hereafter described, it shall offer the Disclosing Party a [? %] participating interest in such acquisition. If accepted by Disclosing Party, it shall pay its proportionate share of the costs of making the acquisition incurred by the Receiving Party or its Affiliated Companies.

Extensive AMI example:

ARTICLE 14
AMI LANDS
(a) The Parties hereby agree to the establishment of the AMI Lands. Subject to subparagraph (c) hereof, if any Party acquires any interest for which at least fifty percent (50%) of the area involved falls within the AMI Lands during the period commencing on the Effective Date and, subject to Article 14.4, ending on the date that this Agreement expires pursuant to Article 15 (which period is herein called the "AMI Term"), then such acquiring Party ("Notifying Party") will forthwith notify the other Parties with full particulars of the obligations and expenditures to
be made for such interest, whereupon such other Parties shall, at any time up to sixty (60) days from the date of such notice, have the right to acquire in accordance with subparagraph (b) a share of the interest so acquired by such Notifying Party (including any such interest included under Article 14.3) by agreeing to assume the equivalent share of the obligations and expenditures corresponding thereto.

(b) The rights under subparagraph (a) shall, unless otherwise agreed by the Parties agreeing to participate in the acquisition, be shared in proportion to the respective Participating Interests of each of such Parties (including the Notifying Party) in the Contiguous Portion.

(c) The rights and obligations in this Article 14.1 shall not apply to any interests acquired pursuant to a joint bid submitted under Article 14.2 nor to any acquisition of an interest pursuant to Articles 4 or 5.

14.2 **Joint Bids**

If any Party wishes to participate in any bid or other acquisition process to acquire a New Crown Interest during the AMI Term, such Party shall notify all the other Parties having a Participating Interest in the Contiguous Portion and such Parties who wish to consider participating in such acquisition shall meet and endeavour in good faith to agree upon a joint bid or offer for such New Crown Interest. Unless otherwise agreed by the Parties interested in such acquisition, any joint bid or offer shall provide for them to acquire the New Crown Interest in proportion to their then applicable Participating Interests in the Contiguous Portion, determined as provided in Article l4.l(b). If the Parties agree upon a joint bid or offer, it shall be submitted on their behalf by the Operator or other Party agreed upon for such purpose and the bid or offer shall identify that it is a joint bid or offer of the Parties. If the Parties are unable to agree upon a joint bid or offer, then any party may submit an independent bid or offer for the New Crown Interest provided that, if the Party obtains the New Crown Interest for a price or for work commitments that differ in value by more than 5% from the terms it proposed to offer during the joint discussions, then such acquiring Party shall forthwith offer in writing to each other Party having a Participating Interest in the Contiguous Portion an undivided interest in the New Crown Interest equal to such other Party's applicable Participating Interest in the
Contiguous Portion, determined as provided in Article l4.l(b), and such offer shall be accompanied by a statement in writing of the amount of total consideration, including any cash payments, bonuses or work commitments, that the acquiring Party made to acquire the New Crown Interest. Each such other Party will have thirty (30) days in which to accept such offer by notice in writing to the acquiring Party, accompanied by a written assumption of its share of the total consideration and immediate payment of its acquired share of any cash or bonus consideration that it knows to be already paid by the acquiring Party. Upon delivery of any such acceptance and consideration within the thirty (30) days, the accepting Party shall acquire such interest in the New Crown Interest. A failure to provide such notice and assumption within the thirty (30) days shall be deemed to be a
waiver of any right to acquire a share in the New Crown Interest under this Article 14.

14.3 **Affiliates**
This Article 14 shall also apply to any acquisition of an interest within the AMI Lands during the AMI Term by any Affiliate of a Party and such Party shall be responsible for compliance by such Affiliate with this Article.

Example Preferential Right of Purchase

GOM Offshore Model JOA 2007

1.1 Preferential Right to Purchase

Any Transfer of Interest shall be subject to the following provisions:

1.1.1.1 Notice of Proposed Transfer of Interest

The transfer notice shall provide full information about the proposed Transfer of Interest, including, but not limited to, the name and address of the prospective assignee (who must be ready, willing, and able to acquire the interest and deliver the stated consideration therefore), the full consideration for the Transfer of Interest, and all other terms of the offer.

☐ *[Optional provision; check if the following to be applicable.]*

In the case of a package sale of oil and gas interests that includes all or part of the assigning Party's Working Interest, or if the proposed Transfer of Interest is structured as a like kind exchange, the Working Interest that is subject to the Transfer of Interest shall be separately valued and the transfer notice shall state the monetary value attributed to the Working Interest by that prospective assignee. Article 24.2 *(Preferential Right to Purchase)* shall apply only to the Working Interest that is subject to the Transfer of Interest.

1.1.1.2 Exercise of Preferential Right to Purchase

Within _____________ (___) days from receipt of the transfer notice, each non-assigning Party may exercise its preferential right to purchase its Participating Interest Share of the Working Interest offered (on the same terms and conditions, or on equivalent terms for a non-cash transaction as stated in the notice) without reservations or conditions by written notice of that fact to all of the Parties. If a non-assigning Party does not exercise its preferential right to purchase its Participating Interest Share of the Working Interest offered and the non-assigning Parties, who wish to exercise their preferential right to purchase, do not agree to pay the full consideration for the Transfer of Interest and accept all of the other terms of the third party offer within _____________ (___) days of the _____ (__) day period in which the non-assigning Parties may exercise their preferential right to purchase, the assigning Party shall be free to complete the proposed conveyance on the terms disclosed in the notice. If the other non-assigning Parties agree to pay the full consideration for the Transfer of Interest and accept all of the other terms of the third party offer, the assigning Party shall transfer the Working Interest to the non-assigning Parties who exercised their preferential right to purchase under this Article 24 *(Transfer of Interest and Preferential Right to Purchase)*. The Transfer of Interest shall be concluded within a reasonable time, but no later _____________ (___) days after the applicable period in which the non-assigning Parties may exercise their preferential right to purchase.

1.1.1.3 Transfer of Interest Not Affected by the Preferential Right to Purchase

Article 24.2 *(Preferential Right to Purchase)* shall not apply when a Party proposes to:

(a) mortgage, pledge, hypothecate, or grant a security interest in all or a portion of its Working Interest (including assignments of Hydrocarbon production executed as further security for the debt secured by that security device), or

(b) grant an overriding royalty, a net profits interest, or a production payment, or

(c) dispose of its Working Interest by:

[Items (i), (ii), and (iii) are optional; check if they are to be applicable.]

☐ (i) a package sale of oil and gas interests that includes all or part of the assigning Party's Working Interest;

☐ (ii) a simultaneous like kind exchange under Section 1031 of the Internal Revenue Code of 1986, as amended ("Code");

☐ (iii) a property exchange transaction other than a non-simultaneous like-kind exchange under Section 1031 of the Code;

(a) merger, reorganization, or consolidation;

(b) a Transfer of Interest of substantially all of a Party's exploration and production properties in the Gulf of Mexico;

(c) a Transfer of Interest to an Affiliate, provided that there is included in the Transfer of Interest a provision that if for any reason the assignee ceases to be an Affiliate of the Transferring Party within ______ (__) years after Transfer of Interest, those rights shall be immediately reassigned to the original Party before the assignee ceases to be an Affiliate, and that all rights of the assignee in the Contract Area shall terminate if the re-assignment does not take place; or

(v) a Transfer of Interest pursuant to Articles 16 *(Non-Consent Operations)*, 17 *(Withdrawal From Agreement),* and/or 18 *(abandonment and Salvage)*.

1.1.2 Completion of Transfer of Interest

If the proposed Transfer of Interest is not executed and filed of record with the MMS within ______ (___) days after receipt of the transfer notice by the non-assigning Parties, or if the terms of the proposed Transfer of Interest conveyance are materially altered, the proposed Transfer of Interest shall be deemed withdrawn, and the Working Interest included in the proposed Transfer of Interest shall again be governed by this Article 24.2 (*Preferential Right to Purchase).*

INDEMNITY CLAUSES

Description of the issue:

Contractual indemnities in oil and gas contracts generally relate to the modification of the common-law approach to allocation of risk. Parties to oil and gas contracts deviate from the standard understanding of risk distribution as accepted in law in order to spread the risks to the ones who can handle it more effectively. Scope of indemnity is a matter of contract negotiations, however, care should be taken when defining (i) the degree of fault that caused liability, (ii) liability towards the parties outside the contract and (iii) extent of associated damages.

The oil and gas industry is a peculiar one. several aspects of the industry—e.g. the capital-intensive nature of the industry, market price volatility, geographic scope of assets and operations, the high-risk nature of exploration and exploitation of natural resources, technology requirements, environmental concerns, downstream brand promotion and protection issues, political sensitivities, scale and diversity of employee base, etc.—give rise to particularly high levels of legal and commercial risk for international oil and gas companies.

Apart from being a lengthy process, determining liability and awarding cost to injured parties is usually a huge burden considering that the industry is characterized by sub-contracting. Risk will be managed and controlled when the risk has been explicitly allocated to one or more parties. Money spent on taking out several insurance policies is considered an additional expense, with the incentive to use contracts to modify common law approach to risk management becoming even more attractive.

The purpose of a contractual indemnity, also known as a *hold harmless clause*, is to amend the common law position.

The Common Law Approach to allocation of Risk

In the absence of a specific agreement, the general law relating to contract and tort/ delict provide for risk allocation under the common law. Liability flows from breach of duty or fault (normally cited as negligence), with the operative word being “negligence”. Subject to considerations such as remoteness of damage, frustration of contract, etc, the party in breach is obliged to compensate the non-breaching party thereby mitigating the loss. Under this system, though exceptions may be made towards shifting the burden of losses when a person is compelled to pay damages occasioned by the negligence of another, he can only be indemnified by the negligent party when there exists, no participatory or contributing fault. Judicial bodies will assume the parties want fault-based indemnities if there is no agreement to the contrary.

Contractual Indemnities

Though not exclusive to oil and gas, one contracting practice which the industry has developed to manage and regulate its physical risks, is the Indemnity clause. An indemnity is an agreement whereby one party agrees to secure another against an anticipated loss or damage by making payment to the party having benefit of the indemnified party in the event that that indemnified party suffered a loss for which the indemnifier agreed to secure him .

There exist two types of indemnities:

(1)The simple indemnity and the (2) Mutual indemnity.

1. The simple indemnity is a "one way traffic" with the burden falling on the indemnifying party to cover the indemnified in the event that the indemnified suffers loss for which he had been secured by the indemnifying party.

2. On the other hand, the Mutual indemnity or common referred to as the "knock for knock" indemnity is circular in nature. Here both parties indemnify each other; the only difference is that the security is in relation to different but related species of loss. "Under the mutual indemnity regime, each party to the contract agrees to take responsibility for, and to indemnify the other against, injury and loss to its own personnel and property and its own 'consequential losses' (by this, the parties generally mean loss of profit and other economic losses).

These cross-indemnities are usually intended to be effective even if the losses arose due to the negligence, breach of statutory duty or breach of contract of the party receiving the benefit of the indemnity".

Relevance of Indemnity clauses in Oil and Gas Contracts

Every business venture possesses both un-foreseeable and anticipated risks accompanying their actualization. However, oil and gas investments generally are very capital-intensive, often making these risks more than just a passing interest. Parties want to make sure that they accurately reflect their intention in the contract in preparedness for any eventuality; the ability to shift liability via contractual provisions is important for oilfield participants, especially when the other alternative is fault based indemnities.

From a legal and commercial perspective indemnity clauses are among the most important clauses in any contract. This is especially relevant for contracts in the oil and gas industry where potential liabilities are enormous. Considering the capital intensive nature of the industry and with the realization that several parties are involved in oil and gas transaction at the same time, it makes economic sense to allocate risk to the party best able to manage a particular type of loss, rather than result to a fault based allocation of risk.

Fault-based indemnities are often enforced through expensive and time-consuming litigation to determine liability and responsibility which, in turn, can lead to increased legal costs. In addition, with insurance premiums on the steady increase, money spent on taking out several insurance policies is considered an additional expense. During production on an oil and gas platform there are usually 20 or more representatives of companies on board. If all parties were required to carry out insurance against the remote but potentially catastrophic risk that might be prone to installation and personnel, the cost involved would be not only be prohibitively expensive for smaller contractors, it would also be an inefficient use of financial resources .

Contract commercial clauses dealing with indemnities are often inserted (in regard to the oil and gas industry) in Confidentiality Agreements, Farmout Agreements, Purchase and Sales Agreements, JOAs and other land related commercial agreements. Since land and access to land is a critical component in the mineral resource business, parties who invest in such resources (and

associated land) are sensitive to optimizing their competitive advantage and protection of their assets.

Purpose for Indemnities

Benefits

The volatility of the substances around which the industry operates suggests that risk is a factor which needs to be anticipated as well as allocated among the parties best equipped to handle it.

Detriments

The option of taking out several insurance policies for each party is not practicable. Not only will it be prohibitively expensive for smaller contractors it would also be an inefficient use of financial resources.

Resulting to common law approach to the allocation of risk is not only a lengthy process, in terms of determining liability and awarding cost to injured parties, but also a time consuming enterprise; a luxury the oil and gas industry cannot afford. Critics have found the imputation of indemnities into oil and gas contracts as unfair and potentially dangerous for parties to use contracts as a vehicle for modifying the common-law's approach to allocation of risk. They argue that it is as the imposition of will by a dominant party on a party with inferior "economic bargaining power," who is being "unfairly" "coerced" into indemnifying the dominant party, stating that the result will rest on the relative bargaining power of the parties. They further argue that in practice, it is difficult to get the balance right and a particular type of loss or poor drafting can, notwithstanding the imposition of non-fault based indemnities, could lead to protracted litigation coupled with the fact that it is virtually impossible to completely avoid a fault-based system of risk allocation. In quantifying likelihood of loss or less-than- expected returns, parties who presume that they are most likely to be affected if " the pendulum swings the wrong way" have the option of taking out a separate insurance policy to mitigate loss. Furthermore, recourse to litigation is a fundamental right of any party and cannot be deprived by contract. However, explicitly drafted and worded agreement minimizes the occurrence of protracted litigation if the litigant is fully aware that he will also bear the cost of litigation in the event that he is unsuccessful.

Enforcement/Remedies of Indemnities

It is well established that indemnity will not lie in respect of loss due to a person's own negligence or that of his servants unless adequate, unambiguous and clear words, and in some cases in 'conspicuous' font lettering, are used or unless the indemnity could have no reasonable meaning or application unless so applied. The general rule is that non-fault based indemnities must be clear and unequivocal, either expressly or by necessary implication, to address important public policy concerns surrounding inter alia indemnification of an indemnitee against liability for death, injury or property damage caused by its own negligence or misconduct, to the extent authorized by law. Generally a party cannot seek indemnification against its own gross negligence or willful misconduct.

The classic three part test dealing with the duty of a court in relation to indemnity provisions follows:

(1) Where a clause contains language which expressly exempts a person in whose favour it is made from the consequence of the negligence of his own servants, then effect must be given to such a provision;

(2) Where there is no express reference to negligence a court must consider whether the words in their ordinary meaning are wide enough to cover the negligence of his own servants;

(3) Where the words used are wide enough for the above purposes then the court must consider whether there is another head of damage on which to base the claim other than negligence

In cases where the parties establish a cap on indemnified language, care must be taken so as not to exclude payment for punitive damages on the basis of Gross Negligence/Willful Misconduct or regulatory fines such as pursuant to the US Foreign Corrupt Practices Act which may far exceed the monetary ceiling of a cap.

Pro-Forma Covenant Clauses

General indemnity example

The Indemnitor to indemnify the Indemnitee in respect of: (i) loss of or damage to the Indemnified Facilities; and (ii) cost, loss, damage and claims by third parties (excluding affiliates, employees, officers and contractors) suffered by the Indemnitee or Indemnitor; in each case arising in connection with the Indemnitee's or Indemnitor's performance, mis-performance or non-performance of their obligations under the Relevant Agreement, including where due to negligence but excluding where due to wilful misconduct/gross negligence/fraud of Indemnitee.

Each Indemnitee and Indemnitor to mutually indemnify and hold harmless the other Indemnitee or Indemnitor, as applicable, for:

- save as provided in the foregoing paragraph, personal injury to, death of, disease suffered by, or loss of/damage to property, including personal property of, in each case the Indemnitor and its affiliates and contractors of any tier and each of its and their officers and employees (and where a contractor is engaged by both the Indemnitor and Indemnitee under separate contracts and any of the foregoing events occur which give rise to an indemnity under this provision, liability will be attributed to the relevant operator (and consequently that operator's Owner Group) under whose contract the contractor was acting at the time such event occurred); and
- pollution emanating from the indemnifying Indemnitor's or Indemnitee's facilities/property;

in each case arising in connection with the Indemnitor's performance, mis-performance or non-performance of its obligations (including obligations of any party comprised within such Owner Group or any operator thereof) under the Relevant Agreement, including where due to negligence but excluding where due to the willful misconduct/gross negligence/fraud of the Indemnitor or Indemnitee being indemnified.

Each Party to mutually indemnify and hold harmless the other Party in respect of the indemnifying Party's consequential loss, with the exception of any sums to be paid under the {cite any applicable exceptions}.

The maximum aggregate liability of each Owner Group pursuant to their respective indemnities (excluding the consequential loss indemnity) will be limited in respect of any one occurrence or incident, or series of connected occurrences or incidents, to **______________________** ($XXXX). Cap will not apply to liabilities caused by a Party's wilful misconduct/gross negligence/fraud.

Benefit of indemnities to extend to affiliates and contractors.

The Parties to have a duty to mitigate any loss arising under the Relevant Agreement.

AIPN Model JOA indemnity example (2002)
Limitation on Liability of Operator

(A) [Except as set out in Article 4.6(C)], neither Operator nor any other Indemnitee (as defined below) shall bear (except as a Party to the extent of its Participating Interest share) any damage, loss, cost, expense or liability resulting from performing (or failing to perform) the duties and functions of Operator, and the Indemnitees are hereby released from liability to Non-Operators for any and all damages, losses, costs, expenses and liabilities arising out of, incident to or resulting from such performance or failure to perform, even though caused in whole or in part by a pre-existing defect, or the negligence (whether sole, joint or concurrent), gross negligence, willful misconduct, strict liability or other legal fault of Operator (or any such Indemnitee).

(B) [Except as set out in Article 4.6(C)], the Parties shall (in proportion to their Participating Interests) defend and indemnify Operator and its Affiliates, and their respective directors, officers, and employees (collectively, the ***"Indemnitees"***), from any and all damages, losses, costs, expenses (including reasonable legal costs, expenses and attorneys' fees) and liabilities incident to claims, demands or causes of action brought by or on behalf of any person or entity, which claims, demands or causes of action arise out of, are incident to or result from Joint Operations, even though caused in whole or in part by a pre-existing defect, or the negligence (whether sole, joint or concurrent), gross negligence, willful misconduct, strict liability or other legal fault of Operator (or any such Indemnitee).

Check Paragraph (C), if desired. Renumber following paragraph if Paragraph (C) is not selected.

[ ] OPTIONAL PROVISION

(C) Notwithstanding Articles 4.6(A) or 4.6(B), if any Senior Supervisory Personnel of Operator or its Affiliates engage in Gross Negligence / Willful Misconduct which proximately causes the Parties to incur damage, loss, cost, expense or liability for claims, demands or causes of action referred to in Articles 4.6(A) or 4.6(B), then, in addition to its Participating Interest

share:

Check one Alternative.

[ ] ALTERNATIVE NO. 1 - No Limitation
Operator shall bear all such damages, losses, costs, expenses and liabilities.

[ ] ALTERNATIVE NO. 2 - Joint Property Limitation
Operator shall bear only the actual damage, loss, cost, expense and liability to repair, replace and/or remove Joint Property so damaged or lost, if any.

[ ] ALTERNATIVE NO. 3 – Financial Limitation
Operator shall bear only the first [__________ U.S. dollars] of such damages, losses, costs, expenses and liabilities.

[NOTE: Consider whether the amount stated as a financial limitation should be adjusted in accordance with an inflation or other index.]

Notwithstanding the foregoing, under no circumstances shall Operator (except as a Party to the extent of its Participating Interest) or any other Indemnitee bear any Consequential Loss or Environmental Loss.

(D) Nothing in this Article 4.6 shall be deemed to relieve Operator from its Participating Interest share of any damage, loss, cost, expense or liability arising out of, incident to, or resulting from Joint Operations.

[NOTE: Consider whether under applicable law the indemnification portions of Article 4.6, Article 7.3 and Article 7.9 must be set out in conspicuous language or meet other legal requirements in order to be enforceable.]

General indemnity clause example.

Notwithstanding the terms of Article 4.7(C), the Party or Parties transferring any property under Article 4.7(A) shall remain liable for and indemnify and hold the other Parties harmless against all liabilities, losses, costs and expenses arising out of or attributable to Facilities Liabilities with respect to the property transferred as a result of acts or omissions that occurred before the Effective Date, without regard to whether such Facilities Liabilities arise before or after the Effective Date.

AIPN Model Pipeline Transportation Agreement (to be built) example indemnity clauses

1.2 Shipper's liability to Taxes
Shipper shall (subject to Article 14.3) pay or obtain the payment of all Taxes arising upstream of the Input Point and downstream of the Delivery Point and shall indemnify Transporter against any liability that Transporter incurs respecting the Taxes.
1.3 Transporter's liability to Taxes

Transporter shall (subject to Article 14.3) pay or obtain the payment of all Taxes arising respecting the Pipeline (including at the Input Point and at the Delivery Point) and shall indemnify Shipper against any liability that Shipper incurs respecting the Taxes.

1.4 General Indemnity from Third Party Claims

Each of Transporter and Shipper respectively, as an Indemnifying Party, shall indemnify, defend, and hold harmless the other Party, as an Indemnified Party, from and against all losses or damages relating to Third Party Claims arising from:

1.4.1.1 the breach of any representation, warranty, covenant, or obligation of the Indemnifying Party under this Agreement; and

1.4.1.2 from any other act, omission, or event for which the Indemnifying Party is liable under this Agreement.

1.5 Indemnification Procedures for Third Party Claims

1.5.1 The Indemnified Party shall promptly notify the Indemnifying Party of the assertion or commencement of any claim, demand, investigation, action, suit, or other legal proceeding for *which indemnity or defense is or may be sought under this Agreement; provided however, that* this notice requirement shall not apply to any claim, demand, investigation, action, suit, or other legal proceeding in which the Parties are adversaries. The failure by the Indemnified Party to so notify the Indemnifying Party shall not relieve the Indemnifying Party of its obligations under this Article 27.2, except to the extent, if any, that it has been prejudiced by the lack of timely and adequate notice.

1.5.2 The Indemnifying Party shall at the Indemnified Party's request assume the defense or settlement of any Third Party Claim with legal counsel reasonably satisfactory to the Indemnified Party;

OPTION

provided that, that the Indemnifying Party shall not settle or compromise any Third Party Claim without the Indemnified Party's prior written consent to the settlement or compromise.

1.5.3 Despite the foregoing:

1.5.3.1 the Indemnified Party shall have the right, at its option and expense, to participate fully in the defense or settlement of any Third Party Claim; and

1.5.3.2 if the Indemnifying Party does not diligently defend or settle any Third Party Claim within a reasonable period of time (in the light of the circumstances) after it is notified of the assertion or commencement a Third Party Claim, then:

1.5.3.3 the Indemnified Party shall have the right, but not the obligation, to undertake the defense or settlement of the Third Party Claim for the account and at the risk of the Indemnifying Party; and

1.5.3.4 the Indemnifying Party shall be bound by any defense or settlement that the Indemnified Party may make as to the Third Party Claim.

1.5.4 The Indemnified Party shall be entitled to join the Indemnifying Party in any Third Party Claim to enforce any right of indemnity under this Agreement. The Indemnified Party shall cooperate with the Indemnifying Party in the defense or settlement of any Third Party Claim and, at the expense of the Indemnifying Party and subject to obligations of confidentiality to other Persons, the Indemnified Party shall furnish any and all materials in its possession and try to make

any and all witnesses under its control available to the Indemnifying Party for any lawful purpose relevant to the defense or settlement of the Third Party Claim.

1.6 Transporter's Indemnity

Without prejudice to the provisions of Articles 21, 24, and 26 and except as expressly provided for in this Agreement, Transporter shall indemnify and keep Shipper fully indemnified from and against:

(a) any loss, damage, liability, costs, or expense (including legal fees) resulting from damage to or destruction by Shipper of any property of Transporter and/or its Affiliates, employees, or contractors arising out of or concerning the performance or nonperformance of this Agreement;

OPTION

except if the loss or damage arises because of the Willful Misconduct and/or Gross Negligence of Shipper.

(b) any loss, damage, liability, costs, or expense (including legal fees) resulting from the injury, disease, ill-health, or death of any of Transporter's employees or the employees of any of Transporter's Affiliates or Transporter's contractors arising out of or concerning the performance or nonperformance of this Agreement;

OPTION

except if the injury, disease, ill-health, or death arises because of the Willful Misconduct and/or Gross Negligence of Shipper;

(c) any loss, damage, liability, costs, or expense (including legal fees) suffered or incurred by Transporter or Transporter's Affiliates, employees, or contractors arising out of or concerning the failure of Shipper to comply with any of its obligations under this Agreement;

OPTION

except if the loss, damage, liability, costs, or expense arises because of the Willful Misconduct and/or Gross Negligence of Shipper;

OPTION

(d) any loss, damage, liability, costs, or expense (including legal fees) to the Transporter's Facilities arising out of the tie-in of the Shipper's Facilities, or of any shut-down of the Transporter's Facilities required for the sole purpose of the tie-in of the Shipper's Facilities, or for the sole purpose of the modification of the Shipper's Facilities.

OPTION

except if the loss, damage, liability, costs, or expense arises because of the Willful Misconduct and/or Gross Negligence of Shipper.

OPTION

27.3.1 The aggregate liability of Shipper arising from its Willful Misconduct and/or Gross Negligence under this Article 27.3 shall be limited to a sum equal to [ ].

1.7 <u>Shipper's Indemnity</u>

Without prejudice to the provisions of Articles 21, 24, and 26 and except as expressly provided for in this Agreement, Shipper shall indemnify and keep Transporter fully indemnified from and against:

(a) any loss, damage, liability, costs, or expense, (including legal fees) resulting from damage to or destruction by Transporter of any property of Shipper [and/or its Affiliates, employees, or contractors] arising out of or concerning performance or nonperformance of this Agreement;

OPTION
except if the loss or damage arises because of the Willful Misconduct and/or Gross Negligence of Transporter;

(b) any loss, damage, liability, costs, or expense (including legal fees) resulting from the injury, disease, ill health, or death of any of Shipper's employees, or the employees of any of Shipper's Affiliates, or any of Shipper's contractors arising out of or concerning the performance or nonperformance of this Agreement; [and]
OPTION
except if the injury, disease, ill health, or death arises because of the Willful Misconduct and/or Gross Negligence of Transporter; and.

(c) any loss, damage, liability, costs, or expense (including legal fees) suffered or incurred by Shipper or Shipper's Affiliates, employees, or contractors arising out of or concerning the failure of Transporter to comply with any of its obligations under this Agreement;
OPTION
except if the loss, damage, liability, costs, or expense arises because of the Willful Misconduct and/or Gross Negligence of Transporter.
OPTION
27.4.1 The aggregate liability of Transporter arising from its Willful Misconduct and/or Gross Negligence under this Article 27.4 shall be limited to a sum equal to [ ].
OPTION
1.8 The Parties acknowledge that if Shipper becomes party to any Cross User Liability Agreement, the liabilities respecting any loss or damage to or contamination of Gas in the Pipeline shall, as between the Parties be governed by the terms of the Cross User Liability Agreement. Cross User Liability Agreement means the agreement that sets out the liability between field owners in a commingled system respecting the Gas losses arising out of or concerning the transportation and processing of Gas in the Pipeline.

STABILITY CLAUSES

Description of the issue:

Foreign Investors in oil and gas upstream (and downstream) projects seek a fair balance in their investment portfolios between the risks being taken and the reward to be earned. Part of that risk management encompasses providing predictability – or Stability – in the investment environment, particularly Host State laws, regulations and rules that affects the rights, interests and benefits of the Investor in an investment project.

In contrast, Host States compete for access to Foreign Investor technology, capital and project management skills by offering various incentives, while simultaneously seeking to maximize Government take associated with development of natural resources.

As the investment environment changes – such as by way of an Investor reducing technical or economic risks in a project, or changes in government regimes, or changes in global economies and political pressure to respond to these changes (be it jobs, welfare or ideological drivers) – Host States can exercise their Sovereign powers at any time that may result in adverse changes to the expectations of Foreign Investors, thereby upsetting the otherwise stable investment environment.

Contract Stability encompasses **Predictability; Protection; Preservation; Sustainability** of an Investor's contractual **rights, interests and benefits** in a contract between an Investor and a Host State. Expectations include…

- Reasonable ROI in relation to risk; right to repatriate profits
- Protection of operating-administration management rights
- Protection of 'title' (to assets, property, production)
- Protection of rights to infrastructure access

Investor Stability protection claim remedies are at best 'clearly ambiguous'…due to the complexity, variability and dynamics of such claims… 'CAVEAT INVESTOR'!

Contract commercial clauses dealing with stability clauses are sometimes inserted (in regard to the oil and gas industry) in title documents with host governments. Since land and access to land is a critical component in the mineral resource business, parties who invest in such resources (and associated land) are sensitive to optimizing their competitive advantage and protection of their assets.

Purpose for Stability

Benefits

In the event of an expropriation, Foreign Investors may have a claim against the Host State for losses suffered by their investments under bilateral and multilateral treaties. There are no clearly agreed guidelines as to how a taken property can be valued. Views are diverse and conflicting. Moreover, there can be uncertainty with regard to the enforcement of any international award. The

two most commonly used valuation methods – "Net Book Value" and "Discounted Cash Flow" (DCF) have been challenged when used in the context of valuation to compensate for expropriation. Net book value is challenged because it involves accountancy "fiddling" and DCF because it is speculative and invites exaggeration.

The classic view of stabilization (to manage Host State direct or indirect expropriation in the worse case, in contrast to the more common case of where the Host State unilaterally initiates renegotiation tactics designed to increase its take) as a kind of 'freezing' of contract terms over long periods of time has been in decline, and is probably not enforceable;

The interest of IOCs (and their financial advisors and financiers) in contract Stability mechanisms is likely to remain high due to the continuing risk of unilateral alteration of contract terms (or expropriation) by Host States (albeit for a variety of reasons);

Detriments

Expropriation is one of the more extreme non-commercial risks faced by Foreign Investors and can take many forms, ranging from direct to indirect and creeping expropriation.

Under international law, there is no prohibition banning Host States from expropriating foreign investments, provided that the taking is for a public purpose, non-discriminatory, made with the payment of adequate compensation and follows due process (a 'legal expropriation').

Methods Host States have used to disrupt Stability (achieve forms of **excusable expropriation)** include**…**

- **Repetitive tax measures**
  - High taxes resulting in indirect confiscatory effect
  - Coercion by way of abusive audit, tax assessment, or tax collection (Yukos in Russia ex.)
- ***Right an injustice (World Economic Challenges)***
  - Unexpected changed circumstances result in claims of unjust positions and renegotiation required
  - Abuses of claims associated with coercive tactics based on mismanagement of HSEC violations and breach of Investor contract terms
- **State of Necessity (Need for public order or essential security)**
  - First priority is welfare of the nations people and relief from global financial crisis burdens
- **Regulatory Acts**
  - Investor **contract breach for not timely commercializing a project** (in contrast to Investor claim a project is not mature enough for development)
- **HSEC Protections**
  - Host State abuse of exercise of police power to enforce public health standards
- **Legal Procedure and Enforcement**

    - Host State claim that Foreign Investor did not have jurisdiction or standing to bring action or fraudulent conduct claims
- **Renegotiation of Treaties**
    - Host States renegotiating BITs/MITs to water down their impacts and to reduce international arbitration exposure

Enforcement/Remedies of Stability Clauses

Investor contract Stability defense tools generally include (i) some form of Stability clause in Agreements, or rely on Bilateral Trade or Multilateral Trade Treaties or Tax Treaties or other National Laws; (ii) choice of strategic influential partners (such as international banks; Government Partners – that provide a form of 'political' insulation or inconvenience factor); (iii) Political risk insurance; or (iv) type of contract that can influence Stability rights (PSC/PSA , RSC, Concessions). [*In 2007, 1/3rd of International Arbitration cases involved downstream type investors, indicating wider arena beyond just upstream resource Investors in which Host States are challenging contracts].*

Host State compensation Drivers generally encompasses limitation of damages to net book value (original investment less depreciation).

Investor Drivers generally encompasses: (i) Preferred: Damages based on lost profits or discounted cash flow net present value (consequential loss)…promoted by threatening or invoking the following tactics…; Threat of international (publicly aired) arbitration, Host State prefer to avoid…negotiate; Threat of an exit strategy; securing most favorable settlement terms and (ii) Least Preferred: Negotiate on Host State's terms, migrate to less favorable agreement, dropping any treaty or contract-based claims…; In exchange for access to additional resources and other prospective profitability in the Host State

Four tests to determine if expropriation has taken place

- The sole effect test
    - Effect on the investment; degree of interference by the Host State
- Legitimate expectations test
    - Have the Investor's reasonable expectations been violated?
- The purpose test
    - Focus on the purpose of the Host State action
- The proportionately test
    - Are the Host State actions proportional to the public interest protected and to the protection legally granted to Investor?

Forums in which to advance enforcement of stability claims include: Institutional Forms (Administrative procedure), such as

- International Centre for Dispute Resolution of the American Arbitration Association (ICDR)
- International Centre for the Settlement of Investment Disputes (ICSID advantage is that Host State has already committed to and accepted enforcement of rulings)
- International Court of Arbitration of the International Chamber of Commerce
- London Court of International Arbitration (LCIA)
- Singapore International Arbitration Centre (SIAC)

- Arbitration Centre of the Stockholm Chamber of Commerce (SCC); or

Ad Hoc Forum (Non-Administrative procedure), such as

- United Nations Commission on International Trade Law (UNCITRAL, unlike self enforcing ICSID forum, involves pro-active enforcement by national courts)

The 'modern' versions of contract Stability – in which the risk has been shifted mainly from the Foreign Investor to the Host State - are ones that provide for a built in practical renegotiation process designed to achieve a re-balancing – a win-win philosophy - of the Investor benefits from a contract in the event of Host State unilateral action, as well as reliance on supplemental stabilization tools (such as reliance on Bi- or Multi-Lateral Investment Treaties; Tax Treaties; Energy Charter Treaty; partnering with strategic partners (global financial institutions – which have influence in a broad range Host States businesses); Purchasing political risk insurance); Parliamentary approval of a petroleum license where possible (such as a PSC) as a legislative law unto itself; Ensuring some form of enforceable international arbitration in cases of dispute

Guidance on the enforceability of Stability clauses is sparse and only available by analogy (primarily because most Stability resolutions are private and not published);

Considerable diversity in the design of stabilization clauses remains (in particular depending on if a Host State is Developing, in Transition or Developed) with hybrid forms and approaches to economic balancing (there is no one size fits all); Stability clauses generally fall within 1 of 4 categories: **Freezing, Prohibition on unilateral changes, Rebalancing of benefits, Allocation of burden**;

- **Freezing** type clauses (earliest method) was designed to…
  - 'Handcuff' the State from making any changes to law that would affect the contract; Sovereign rights are 'given up'; Always suspect since what Parliament gives up, Parliament can take back; or *The King Can Do No Wrong* doctrine.; Freeze wording should be conspicuous and clear and compelling evidence of extent of Stability interpretation.
- **Prohibition of unilateral change** clauses (also known as 'intangibility' clauses) are designed to…
  - Freeze contract terms but not freeze Host State right to change laws; Parties to contract cannot unilaterally make changes without mutual consent; Prohibition clauses are in practice a noncontroversial procedural path for win-win re-negotiation
- **Rebalancing of Benefits** provide for the Host State Sovereign right to…
  - Make changes in laws; The parties agree to negotiate (in 'good faith' using 'best endeavours' in a 'timely fashion', or resort to agreed deadlock breaking mechanism); To put the contract back (scope of restoration defined) to the original economic benefit ('neutralize' the offending new law changes) and if can't agree, a process to determine compensation…
- Seek to **allocate the burden** created by an attempted unilateral change in the law…

- No balancing is implied…; The NOC pays for any additional burdens (reduces its economic take in the Contract; pays cash to offset the burden – tax, royalty, etc)

Reasonable due diligence before conclusion of the petroleum contract is an essential requirement for the IOC before trying to rely on a stabilization clause;

For cross-border, regional projects, IOCs are experimenting with innovative approaches to stabilization; In non-fiscal areas, such as environmental, safety and health matters (the police powers of a nation), Host States usually seek to exempt them from stabilization. On occasion a Host State can abuse its police powers which in reality becomes indirect or creeping expropriation.

Contracts from non-OECD countries are more likely than those from OECD countries to insulate the investor from new social and environmental laws or to provide compensation to the Foreign Investor for compliance with new social and environmental laws, because of the putative high risk factors in developing countries, and In these areas, IOCs are seeking to develop mechanisms that 'manage' the resulting risks and provide them with a measure of stability.

Pro-Forma Stability Clauses

Some **drafting guidelines**:

- To avoid claim that Stability protection is unrealistically in perpetuity and therefore invalid, *include deadline in agreement* (ex., life of agreement; 80 years; etc.).
- Include '*Good Faith' and 'Best Endeavours'* standard terms whenever Stability enforcement process is to be invoked.
- Internationalize contracts as much as possible by including mixture of 'International Law' and local law standards to enhance enforceability of Stability expectations.
- Take advantage of international treaties (BIT, MIT, TT) and include 'Fair and Equitable Treatment (FET)' language in documents to enhance Stability expectations. Ensure language is conspicuous (bold, big type, up front, etc).
- Broad based language may be helpful to capture scope of Stability expectations, such as…
  - *…any changes to legislation, laws, regulations, executive orders or decrees, administrative rulings, policies, interpretations, judicial or court rulings, procedural rulings, affecting legal, fiscal, economic, commercial, financial, tax, marketing, operational, accounting, HSEC, etc…*
- Structure Stability clause such that Investor has the unilateral right to claim or determine whether or not a detrimental or adverse triggering event has occurred.
- Stability clause designed not only to neutralize unintended burdens, but also capture an entitlement right to enjoy any increased benefits as a result of any changes.
- Be specific in what constitutes triggering events of Stability breach; Breach is recognized under local law; and Government agent has authority to approve the investment contract and terms.
- Basis of damages should be well defined.
- Has Host State subscribed to

- ***Energy Charter Treaty; BIT or MIT; ICSID; Free Trade Agreements; NY Convention; Aarhus Convention (Denmark, 1998, access to information, public hearings, environmental justice); Espoo Convention (Finland, 1991, Environmental Impact Assessments); LSAs; Host State Constitution; Local Investment Laws***

- Risk sharing or proration, and common objectives with local partner (NOC, state agency)
- Membership in EU to promote common objectives
- International Treaties (Bilateral Investment Treaty; Multi-Lateral Investment Treaties; Tax Treaties) should be drafted and interpreted to promote Fair and Equitable Treatment (FET) status in regard to Investor legitimate expectations of Stability
- Scope of Treaties need to be well understood to ensure Stability expectations are met
    - All encompassing ('umbrella' Treaty), covers ANY dispute?
    - Specific Stability coverage, such as commercial impacts, cover only cited event?
    - Hybrid Stability where Host State provides guarantees against certain acts.
- Choice of law that governs an agreement is important…
    - Internationalize contracts as much as possible by including mixture of 'International Law' and local law standards to enhance enforceability of Stability expectations.

Example Clauses:

Kurdistan PSA example*: 43.2 The obligations of the CONTRACTOR resulting from this Contract shall not be aggravated by the GOVERNMENT and the general and overall equilibrium between the Parties under this Contract shall not be affected in a substantial and lasting manner.*
43.3 The GOVERNMENT guarantees to the CONTRACTOR, for the entire duration of this Contract, that it will maintain the stability of the fiscal and economic conditions of this Contract, as they result from the Contract and as they result from the laws and regulations in force on the date of signature of this Contract. The CONTRACTOR has entered into this Contract on the basis of the legal, fiscal and economic framework prevailing at the Effective Date. If, at any time after the Effective Date, there is any change in the legal, fiscal and/or economic framework under the Kurdistan Region law or other law applicable in the Kurdistan Region which detrimentally affects the CONTRACTOR, the terms and conditions of the Contract shall be altered as to restore the CONTRACTOR, to the same overall economic position as that which CONTRACTOR would have been in, had no such change in the legal, fiscal and/or economic framework occurred.
43.4 If the CONTRACTOR believes that its economic position has been detrimentally affected as provided in Article 43.3, upon the CONTRACTOR's written request, the Parties shall meet to agree on any necessary measures or making any appropriate amendments to the terms of the Contract with a view to re-establish the economic equilibrium between the Parties and restoring the CONTERACTOR to the position it was in prior to the occurrence of the change having such a detrimental effect. Should the Parties be unable to agree on the merit of amending this Contract and/or any amendments to be made to this Contract within ninety (90) days of CONTRACTOR's request (or such other period as may be agreed by the Parties), the CONTRACTOR shall be entitled to request the benefit of any future changes to the petroleum legislation or any other legislation complementing, amending or replacing it.

21.1 The Tax Regime set forth in the Contact shall be permanently in effect until the expiration of the Term of the Contract.
21.2 If changes are made in the law after the Contract signing date that make further observance of the original terms and conditions of the Contract impossible or that lead to a significant change in its general economic terms and conditions, the Contractor and representatives of the Competent Body and Tax Agencies may make changes in or correction to the Contract that are needed to restore the economic interests of the Parties as of the Contract signing date. These changes in or correction to the Contract terms and conditions shall be made within sixty days of the time of written notification of a Tax Agency or the Contractor.

***Nigeria PSC Example**: Should the income of the state or the Contractor be materially altered as a result of new laws, orders or regulations then, in such an event, the Parties shall agree to make the necessary adjustments to the relevant provisions of this Contract, observing the principle that the affected party shall be restored to substantially the same economic condition as it would have been in had such change in laws or regulations not occurred. The cost of such restoration to the other Party may not exceed the benefit received by such other party as a result of such change.*

***Egypt PSC example**: In case of changes in existing legislation or regulations applicable to the conduct of Exploration, Development and production of Petroleum, which take place after the Effective Date, and which significantly affect the economic interest of this Agreement to the detriment of CONTRACTOR or which imposes on CONTRACTOR an obligation to remit to the ARE (Arab Republic of Egypt) the procedes from the sales of CONTRACTOR'S Petroleum, CONTRACTOR shall notify EGPC (the NOC) of the subject legislative or regulatory measure.. In such case, the Parties shall negotiate possible modifications to this Agreement designed to restore the economic balance thereof which existed on the Effective Date.*

- *The Parties shall use their best efforts to agree on amendments to the Agreement within ninety (90) days from aforesaid notice.*
- *These amendments to this Agreement shall not in any event diminish or increase the rights or obligations of CONTRACTOR as these were agreed on the Effective Date.*
- *Failing agreement between the Parties during the period referred to above in this Article XIX, the dispute may be submitted to arbitration, as provided in Article XXIV of this Agreement.*

***Vietnam PSC example**: ...both to maintain the CONTRACTOR's rights, benefits and interests hereunder, including CONTRACTOR's share of Profit Oil or Profit Gas, as at the Effective Date and to ensure that any revenues or incomes or profits, including any one or more of the foregoing, derived or to be derived to the CONTRACTOR under this Contract, shall not in any way be diminished in comparison to that which was originally contemplated as a result of such changes…*

- *Iraq-Kurdistan (Allocation only applies to Host State): The GOVERNMENT shall indemnify each CONTRACTOR entity upon demand against any liability to pay any taxes, duties, levies, charges, impositions or withholdings assessed or imposed upon such entity which relate to any of the exemptions granted by the GOVERNMENT under this Article 31.1*
- *Algeria (Allocation is mutually shared between Host State NOC and Investor): In the event of changes in the Algerian laws made after this Contract is signed,*

which result in a substantial reduction of the rights or increase in the obligations of one of the other party, Sonatrach (the NOC) and Partner (the Investor) will negotiate amendments to re-establish the same rights as those agreed on the date of the Contract was signed.

General HGA (Host Government Agreements) example model clause

The Host Government shall take all actions available to it to restore the economic Equilibrium established under this Agreement and any other Project Agreements if and to the extent the Economic Equilibrium is disrupted to or negatively affected, directly or indirectly, as a result of any change (whether the change is specific to the Project or of general application) in [name of country] law (including any laws regarding taxes, health, safety and the environment) occurring after the Effective Date, as applicable, including changes resulting from the amendments, repeal, withdrawal, termination, expiration of [ ] law, the enactment, promulgation or issuance of [ ] law, the interpretation of application of [ ] law, the enactment, promulgation of or issuance of [ ] law, the interpretation or application of [ ] law,(whether y the courts, the executive or legislative authorities, or administrative or regulatory bodies), the decisions, policies or other similar actions of judicial bodies, tribunals and courts, the local Authorities, jurisdictional alterations, and the failure or refusal of judicial, bodies, tribunals and courts, and/or the Local Authorities to take action, exercise authority or enforce [ ] law (a Change in Law).

Cross Border Energy Projects example

- *…"any domestic or international agreement, any legislation, promulgation, enactment, decree or regulation; or any other form of commitment, policy or pronouncement or permission [that] has the effect of impairing, conflicting or interfering with the implementation of the Project, or limit, abridging or adversely affecting the value of the Project or any of the rights indemnification or protections granted or arising under this Agreement or any other Project Agreement;"….*
- *…"the Host Government is to have no liability to the Investor in relation to a Change of Law that is specifically authorized in relation to environmental and safety standards, labour standards, social impact standards and technical standard, that are applicable to the cross-border project"…*
- West African Gas Pipeline Project provides other examples of the scope of a Change in Law..
  - *a decision of a court or tribunal that the Agreed Regime or part of it is not in force or is not valid;*
  - *the coming into force in a state of a law, as a consequence of which the Agreed Regime or part of it ceases to be in force or maintained;*
  - *The entering by a Host State into any international agreement or similar or other commitment that conflicts with, impairs or interferes with, or adversely affects such state's performance of or ability to perform its obligations under the Treaty or agreement or implementation of the project.*
- *Linking compliance with the Vienna Convention on the Law of Treaties of 1969, might be expected to enjoy a higher legal status than those under the investor-host state agreements alone, since a treaty is usually 'insulated' from unilateral actions of a host state that may amount to a breach of contract.*

International Pipeline Projects provides additional examples of Stability protection clauses

- *…" state authority to take all action available to them to restore the Economic Equilibrium established under the Project Agreements if an to the extent that Economic Equilibrium is disrupted or negatively affected, directly or indirectly as a result of any change"…*
- *…"In the event that the State Authorities should ever carry out any act of Expropriation with respect to the Project, the State Authorities shall do so only where such Expropriation is (i) for a purpose which is an overriding public purpose, (ii) not discriminatory, (iii) carried out under due process of law and (iv) accompanied by the payment of compensation as provided."…*
- *'Due process' in respect of a claim is to include the parties' right to resort to arbitration under the Agreement to (1) establish that an expropriation has taken place; and (2) to assess the amount owed by the State Authorities as adequate compensation for loss or damage arising from the expropriation.*
- *…"notwithstanding any change in the constitution, control, nature or effect of all or any of them and notwithstanding the insolvency, liquidation, reorganization, merger or other change in the liability, ownership or legal existence of the state authorities (including the partial or total privatization of any state entity)."…*

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