Neutral Citation Number: [2018] EWCA Civ 25

Case No: A3/2016/3208

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT
QUEEN'S BENCH DIVISION
COMMERCIAL COURT
MR RICHARD SALTER QC (Sitting as a Deputy High Court Judge)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 18/01/2018

Before:

THE RIGHT HONOURABLE LORD JUSTICE LONGMORE
THE RIGHT HONOURABLE LADY JUSTICE HALLETT DBE
and
THE RIGHT HONOURABLE LORD JUSTICE SINGH

- -

Between:

MONDE PETROLEUM SA	**Appellant/ Claimant**
- and -	
WESTERNZAGROS LIMITED	**Respondent/ Defendant**

- -
- -

Mr Rhodri Davies QC (instructed by **Edmonds Marshall McMahon**) for the **Appellant**
Mr Gavin Kealey QC, Mr Thomas Sprange QC & Ms Ruth Byrne (instructed by **King & Spalding LLP**) for the **Respondent**

Hearing dates: 19th December 2017

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Approved Judgment

Lord Justice Longmore:

Introduction

1. This appeal turns on the true construction of a clause in an agreement for consulting services of 23rd April 2006 ("the CSA") whereby the claimant and appellant Monde Petroleum S.A. ("Monde") agreed to provide services to assist the respondent Westernzagros Ltd ("WZL") in obtaining an oil Exploration and Production Sharing Agreement ("EPSA") with the Kurdistan Regional Government ("KRG").

2. An important background to the CSA was that at the material time (as accepted by Monde's expert in Iraq law) it was a matter of debate whether it was the KRG or the Federal Government of Iraq (or both) that had the power or the authority to grant concessions, such as the EPSA in Kurdistan.

3. Monde is a British Virgin Islands company run by Mr Yassir Al-Fekaiki. Mr Al-Fekaiki is a British national of Iraqi origin, whose father was, until his death in 1997, a prominent Iraqi politician and one of the leaders of the opposition to Saddam Hussain.

4. WZL is a Cypriot-registered company with its headquarters in Calgary, Canada. Until late 2007, it was a wholly-owned subsidiary of Western Oil Sands Inc ("WOSI"), a Canadian oil and gas company whose principal business was an oil sands project in Athabasca, Alberta. In 2007, WZL was "spun out" of WOSI and became the sole asset and a 100% subsidiary of Western Zagros Resources Limited, a Canadian.

Factual background

5. In the period following the fall of Saddam Hussein's regime, the KRG sought investment in the oil and gas industry from multi-national companies with experience of oil exploration and production.

6. In early 2006, WZL was attempting to negotiate an EPSA with the administration of the KRG, with a view to exploring for oil and developing oil production in that province of that region of Iraq.

7. On 23rd April 2006, WZL and Monde agreed the CSA under which services were to be provided by Mr Al-Fekaiki which were intended to assist WZL to conclude its EPSA negotiations successfully. Monde's reward for these services was to take the form of monthly fees, success fees payable on the achievement of certain specified milestones, and an option to acquire (in certain events) a 3% working interest in the EPSA. That option was to vest only upon the occurrence of the final milestone.

8. On 4th May 2006, an EPSA was executed between the KRG and WZL, but was never formally ratified by the KRG. Over the following months, the KRG required amendments to be made. Those amendments had the effect of reducing WZL's contract area from 3,700 km to 2,120 km, and of revising the fiscal terms to make them more favourable to the KRG and less favourable to WZL. An amended and restated EPSA was executed on 26th February 2007 and was formally ratified by the KRG a few days thereafter.

9. On 8th November 2006, Mr Hatfield of WZL sent to Mr Al-Fekaiki of Monde a "clean signed copy of the CSA as requested". That copy bore a fresh signature page with a new signature by Mr Frangos (an executive of WZL), and incorporated in typescript manuscript amendments which had been made to the 23rd April 2006 version. There were, however, no other changes from 23rd April 2006 version. In particular, no change had been made to the date or to the provisions of Article 10 of the CSA relating to its term and termination.

10. On 16th March 2007 WZL served a Termination Notice on Monde, intending to bring the CSA to an end. On 18th April 2007 WZL and Monde executed a Termination Release Agreement ("the Termination Agreement"). Under the Termination Agreement, in consideration of the payment by WZL of US$ 700,000 (a sum to which Monde asserted it was already contractually entitled), Monde agreed that the CSA was at an end, and WZL and Monde released each other from all further liabilities. It is common ground that, at that point, Monde's 3% option under the CSA had not vested.

The Dispute

11. In proceedings brought in the Commercial Court Monde claimed that its signature to the Termination Agreement was procured by misrepresentation and/or economic duress. On that basis, Monde sought to set aside the Termination Agreement and/or to claim damages, asserted that the Termination Notice was invalid and that, by serving it, WZL committed a repudiatory breach of the CSA, entitling Monde to substantial damages for the loss of its rights under the CSA, including its 3% option.

12. WZL denied making any misrepresentations or exercising any duress to procure the Termination Agreement. WZL also said that, even if Monde were to succeed in its claims relating to the Termination Agreement, Monde would be unable to prove any or any substantial loss because, on WZL's case, the Termination Notice was itself effective to bring the CSA to an end, or (if that be wrong) WZL would have been entitled to serve a further such notice. In either event, no further payments would have become due to Monde under the CSA, and Monde's 3% option would never have vested.

13. The judge held (among many other things) that the Termination Agreement had been procured by misrepresentation but that Monde could not prove any loss following from the because WZL was at all times entitled to terminate the CSA on notice thus ensuring that Monde would never have been in the position to exercise its 3% option.

The CSA

14. Relevant terms of the CSA are:-

> "10. <u>TERM</u>
>
> 10.1 Subject to the provisions of this Article 10, this Agreement shall be effective for a period of 4 months from the effective date hereof.

> 10.2 Notwithstanding section 10.1, this Agreement shall continue if the EPSA is executed within 4 months from the date hereof or, if the EPSA is not executed, at the election of [WZL], provided that this Agreement and the option contemplated in Schedule "C" (the Option) may be terminated by [WZL] upon thirty days' notice to [Monde] should the EPSA not become fully operational and enforceable within six months from the date hereof. If this Agreement is continued as set out above, on the 1 year anniversary of this Agreement it shall terminate with respect to the payments contemplated in Schedule "B", unless mutually extended for 1 year terms.
>
> 10.3 Notwithstanding the provisions of Section 10.1 and 10.2 above, this Agreement and the Option may be terminated:
>
> > (i) by [WZL] upon thirty days' advance written notice to [Monde] if it becomes manifestly apparent that an operational and enforceable EPSA in form and on terms acceptable to [WZL] cannot be concluded;
> >
> > (ii) by either party immediately in the event the other party commits a material breach of this Agreement which remains uncured after the period for curing specified in the notice of the breach has expired;
> >
> > (iii) by mutual written agreement of the parties;
> >
> > (iv) by election of [WZL] on the termination of the EPSA; or
> >
> > (v) by [WZL] if it is manifestly apparent that achievement of the milestones set out in Schedule "B" are being achieved primarily as a result of activities of third parties"

15. Schedule B detailed the payments Monde was to receive under the CSA. It detailed the set monthly payments and also three potential success fees which became payable on completion of three relevant milestones. Those were:-

> "(c) Success fees as follows:-
>
> i) US$ 550,000 upon commencement of the Seismic Program ... following signature of the EPSA and associated agreements ... or 2 months after the signature by all appropriate parties of the EPSA, whichever comes first;
>
> ii) US$ 550,000 following completion of the first 250 kms of the Seismic Program and within one month of the EPSA becoming effective, i.e. passed into law by the Unified Government of Kurdistan, whichever comes last; and

iii) US$ 600,000 following completion of the first 500 kms of the Seismic Program and within one month of [WZL] receiving a signed copy of the Confirmation and Support Letter of the Government of the Republic of Iraq (substantially in the form attached in Schedule "D" or a letter having the same effect) acknowledging the EPSA, all to the satisfaction of [WZL]."

The final sentence of Schedule B stated that "the Option shall only vest upon the events described in (c) above having occurred."

The Issues

16. There are only two issues on which permission to appeal has been given:-

i) whether the phrase "fully operational and enforceable" in respect of the EPSA in clause 10.2 means (as Monde contends) that it was sufficient that the Unified Government of Kurdistan (or in other words the KRG) had ratified the EPSA (or passed it into law); or (as WZL contends) that all the Schedule B milestones had to be passed including the receipt of a signed copy of the letter of the Government of the Republic of Iraq as referred to in (c)(iii) and Schedule D referred to in the milestones; and

ii) whether, in the event that WZL became entitled to serve a 30 day notice pursuant to the proviso in clause 10.2, such notice had to be given immediately or could be given at anytime while there was no "fully operational and enforceable" EPSA.

17. The deputy judge held that the EPSA was not fully operational and enforceable until such time as the Government of Iraq had signed a letter confirming the ESPA and that there was no requirement that WZL should give notice of termination immediately.

18. Monde now appeals both those conclusions. It also sought permission to allege that the notice of termination had to be given, if not immediately, then within a reasonable time of the six month date specified in the clause. The six month period expired on 23rd October 2006. Monde wanted to argue that WZL's termination notice of 16th March 2007 was served well after any reasonable period had expired.

19. Monde needed permission to serve a supplementary skeleton and (in our view) permission to amend the notice of appeal. In the course of the argument, for reasons we then gave (mainly because the question of reasonableness could have been, but was not, addressed in the evidence and submissions below), we refused permission.

"Fully operational and enforceable" EPSA

20. I take first the meaning of "fully operational and enforceable" in clause 10.2. It is not the first reference to a fully operational and enforceable EPSA because the very first clause of the CSA provides that Monde agrees to perform "such services described in Schedule A to [the CSA] as [WZL] shall request". The first sentence of Schedule A says that Monde will advise and assist WZL in concluding and maintaining a "fully operational and enforceable" EPSA between the KRG and WZL. It is not, therefore, sufficient that the end object of the assistance should be an EPSA which cannot be

fully enforced or cannot be fully operated. The phrase must have the same meaning in clause 10.2 as in clause 1.1 with its incorporation of Schedule A.

21. The judge held that in circumstances, in which Monde's expert in Iraqi law accepted that the KRG and the Federal Government of Iraq had differences of view as to the extent of the KRG's authority to grant exploration and production agreements in relation to Kurdistan and that the issues whether KRG was entitled or had the authority to enter into such agreements and even whether the KRG owned the oil fields in Kurdistan at all had not been decided "appropriately to the acceptance of all the political players", mere ratification of the EPSA by the KRG did not render the agreement "fully operational and enforceable". For that to be the case both the KRG and the Federal Government of Iraq had to be, as the deputy judge put it in para. 307 of his judgment, "onside". The only way that was going to happen was a documented consent to the EPSA on the part of the Iraqi Government in some such form as expressly contemplated by the third milestone in Schedule B (c)(iii) and that had not happened.

22. The deputy judge also relied on the further context in which the CSA had been agreed which was that several companies seeking concessions in Kurdistan had required similar letters from the Federal Government and that Mr Al-Fekaiki had stated that he was "very confident" than an appropriate letter from the Federal Government could be obtained within 6 months.

23. Mr Rhodri Davies QC for Monde submitted:-

    i) the deputy judge read into the words "fully operational and enforceable" a requirement that a letter in the form required by Schedules B and D had to be in existence when there was no warrant for making such an implication;

    ii) the deputy judge construed the phrase by reference to the subjective intention of WZL that it wished to have such a letter in place from the Federal Government of Iraq;

    iii) the deputy judge speculated that unidentified parties might in the future (after the CSA was agreed) claim that entitlements of WZL under the agreement could not be enforced or operated. The phrase could not be construed in the light of some subsequent political impediment; and

    iv) the deputy judge had fallen foul of the first factor stipulated in the judgment of Lord Neuberger of Abbotsbury PSC in Arnold v Britton [2015] A.C. 1619, 1628 namely that commercial common sense and surrounding circumstances should not be invoked to undervalue the importance of the language of the provision which is to be construed.

24. None of those submissions is a fair criticism of the deputy judge, who recorded (para 295), Monde's submission before him that the phrase "fully operational and enforceable" should be interpreted as meaning, in the words of the second milestone set for payment of the second success fee in Schedule B of the EPSA, "effective i.e. passed into law by the Unified Government of Kurdistan". He also recorded WZL's submission that it made much better sense, in the light of the uncertainties mentioned above, for the words "fully operational and enforceable" to refer to the third milestone

of the Confirmation and Support Letter of the Government of Iraq. He rightly recorded the difference between the parties as being simply whether the relevant milestone was the second or third milestone in Schedule B. It was in that context that the judge said (para 308) that the CSA contained its own "implied definition" of "fully operational and enforceable". But the parties had accepted that the critical words referred to a milestone; it was only a question of deciding which milestone was applicable. It is not therefore a case of the judge wrongly reading words into the phrase "fully operational and enforceable"; it was merely a question of what the words mean in the context of the agreement read as a whole and the judge was entitled to use the phrase "implied definition" without being guilty of reading words into the contract which were not there. After all, if the parties had meant "effective" they could have used that word.

25. Nor is it correct to say that the judge construed the critical phrase by reference to the subjective intention of WZL that it wished to have a letter from the Government of Iraq. The judge merely said (para 307) that WZL was not interested in a legal or political wrangle but wanted to get on with the business of exploring for, and then extracting, oil. For that to happen, WZL needed both the KRG and the Iraqi Government "to be onside". This is not to construe the contract according to the subjective intention of one party but is construing the contract against the uncontested background of political reality. That is an entirely permissible exercise. As Mr Gavin Kealey QC for WZL put it, the letter from the Iraqi Government was not just desirable; it was practically required.

26. Nor can I read the judgment as indulging in impermissible speculation about future events. It is rooted fairly and squarely in the commercial and political background which existed at the time when the contract was made.

27. Nor is it right to say that the judge undervalued the importance of the language of the contract by invoking commercial common sense and surrounding circumstances in contravention of the first factor emphasised in Arnold v Britton. It has been axiomatic, since at least Reardon Smith Line Ltd v Yngvar Hansen-Tangen [1976] 1 WLR 989, 995-7 that any commercial contract must be construed against its commercial background or, as Lord Wilberforce put it, in its "factual matrix" (997C). That is what the deputy judge did. In a case in which it was accepted that some words (reflecting a relevant milestone) had to be read into the phrase "fully operational and enforceable" and it was only a question of which milestone was being referred to, it was entirely legitimate for the judge to choose the one which made more commercial sense, in the context of the situation existing at the time the contract was made.

28. Mr Davies also submitted, in line with Monde's original skeleton argument that since Schedule C provided that Monde's option could be exercised 24 months from the commencement of the Seismic Program, as described in Article 4.1 of the EPSA, (or on the declaration of first commercial discovery if earlier), it was contemplated that the seismic programme would be in operation for as long as 24 months; that showed that the EPSA was operational. As long as it could be enforced against the counter-party the KRG, it was also enforceable. It was thus "fully operational and enforceable" at the time WZL purported to terminate the EPSA, as confirmed by Monde's expert Mr Chalabi.

29. As Lord Justice Singh observed in argument, however, that submission is inconsistent with Mr Davies's acceptance that the phrase "fully operational and enforceable" has to be interpreted by reference to one of the milestones in Schedule B. Nor does it give any effect to the word "fully".

30. I would therefore reject the first ground of appeal.

Requirement for immediacy?

31. I turn then to the second ground of appeal that any notice of termination served by WZL must be served "immediately" upon the expiry of the six months given by the proviso in clause 10.2, not some 5 months later.

32. This is a hopeless contention. The clause merely provides that WZL may terminate "should the EPSA not become fully operational and enforceable within 6 months from the date of the EPSA". No requirement of immediacy is expressed and there is no reason for it to be implied. The idea that, if notice is not given immediately, WZL should be locked into the agreement until such time as it can show within the terms of clause 10.3 that it has become "manifestly apparent that an operational and enforceable EPSA ... cannot be concluded" would be highly un-commercial.

33. There can, moreover, be no obvious prejudice to Monde by WZL leaving the position open because WZL takes the risk that a letter of consent from the Iraqi Government will in fact materialise. If it does, it would then be too late to serve a termination notice and Monde will have achieved the third milestone as set out in Schedule B. A deferred notice can therefore potentially benefit Monde without causing them any prejudice.

34. Mr Davies submitted that, if the right to terminate was not exercisable but carried on indefinitely, that meant that clause 10.3(i) was redundant; that sub-clause enables WZL to terminate "if it becomes manifestly apparent that an operational and enforceable EPSA on terms acceptable to WZL cannot be concluded". But that sub-clause gives a further right to WZL which is by no means inconsistent with the right to terminate if a fully operational and enforceable EPSA is not forthcoming within 6 months of the CSA. It sets a higher hurdle for the first 6 months of the contract and is an understandable provision in a contract for oil exploration in a politically uncertain part of the world.

35. It was also said that it was un-commercial to construe the contract in a way that meant Monde continued to be bound, while WZL was able to exercise its right to terminate whenever it wished. But as I have already pointed out, the continuance of the contract until any termination could in fact work to Monde's advantage if it did procure the letter from the Government of Iraq which Mr Al-Fekaiki had always expected to be able to do.

36. On the basis therefore that the only options before the court are to construe clause 10.2 as requiring WZL to exercise its right to terminate immediately on the six month anniversary of the CSA and otherwise forfeiting that right, or as giving WZL the right to terminate it at a time of its own choosing, I would unhesitatingly pronounce for the latter and uphold the deputy judge's decision to that effect. It would, of course, be a

different matter if WZL had affirmed the contract after the right to terminate had arisen but WZL did not do so.

Conclusion

37. I agree with the deputy judge on both matters on which permission to appeal has been given and would, therefore, dismiss this appeal.

Lady Justice Hallett:

38. I agree.

Lord Justice Singh:

39. I also agree.