

OIL & GAS: CASE LAW REVIEW, PRE-EMPTION RIGHTS

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This note reviews case law on pre-emption rights in the context of a sale or transfer of interests under a joint operating agreement. The note translates the key themes that emerge from the case law into practical drafting and dispute resolution tips.

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SCOPE OF THIS NOTE

This note reviews the case law on pre-emption rights in the context of a typical sale or transfer of interests of a company under a joint operating agreement in the oil & gas industry. In such a scenario, disputes as to the existence of pre-emption rights of joint venture partners may arise, and their resolution is often crucial to the conclusion of high-value transactions.

The note unpacks key themes that emerge from the case law pertaining to disputes on pre-emption rights, including when such rights can be raised, when they can be defeated, and how to interpret and apply pre-emption provisions. The note then translates these themes into practical drafting and dispute resolution tips.

WHAT ARE PRE-EMPTION RIGHTS?

Pre-emption rights are sometimes known colloquially as “rights of first refusal”. In the context of a company that intends to issue new shares, a right of pre-emption is the right of existing shareholders to acquire the new shares before they are sold to third parties.

When dealing with the sale or transfer of interests of a company operating under a joint operating agreement (JOA) in the UK, for example, the company’s joint venture partners may have pre-emption rights to purchase the interests. These rights may play an important role in the future of the United Kingdom Continental Shelf (UKCS), where major energy companies may wish to dispose of infrastructure to hedge funds as oil and gas reserves



diminish. They are particularly relevant where the JOA dates from before December 2002 because since then pre-emption rights in UKCS JOAs have only been permissible in exceptional circumstances. For more information, see [Practice note, Joint operating agreements: key issues for drafting, reviewing and negotiating: Pre-emption rights](#).

Litigation concerning rights of pre-emption can be urgent and hard-fought. The exercise of these rights can cause critical delay to high-value transactions since most will have longstop dates.

Example scenario

- A major infrastructure or field interest deal is about to close. Regulatory approvals are in place. Commercial and legal negotiations between buyer and seller took months. The purchase price is in the hundreds of millions.
- A counterparty accuses the seller of failing to honour pre-emption rights under the terms of their JOA.
- For the sale to go through, the seller is at the mercy of the joint owner, who may seek to exercise its commercial leverage to extract concessions in return for lifting its objections.
- Even if the seller has anticipated the pre-emption issues, it may still have to fight a battle to determine whether pre-emption rights have been breached at extremely short notice before a court or tribunal, in order to save the transaction (a strategy successfully deployed by Apache and Ancala in [Apache Beryl I Ltd v Marathon Oil UK LLC \[2017\] EWHC 2258 \(Comm\)](#) (see [Pre-emption disputes can sometimes be resolved on an expedited basis](#) below)).

KEY CASE LAW

A number of key themes arise from the relevant case law on pre-emption rights. These should be borne in mind when disputes arise in this area.

Pre-emption disputes can sometimes be resolved on an expedited basis

In [Apache Beryl I Ltd v Marathon Oil UK LCC \[2017\] EWHC 2258 \(Comm\)](#), Males J ordered the expedited trial of an entire action to be prepared and heard in seven weeks. He held that it was the role of the Commercial Court “to assist commercial people in resolving their disputes”, and that a fair trial was possible given the “limited scope of what is in dispute” (at paragraphs 13 and 27).

The dispute concerned a proposed transaction which subsequently raised issues of pre-emption. The decision is important not only as an authority on contested applications for expedition, but also as an illustration of how a well-timed application can save a transaction. The underlying deal in that case was able to proceed in advance of its longstop date because the order for expedition accelerated negotiations between the parties.

Pre-emption disputes may be resolved by preliminary issues

The narrow scope of pre-emption disputes may make them suitable for an expedited preliminary issues trial, as [United Company Rusal Plc v Crispisan Investments Ltd \[2018\] EWHC 2415 \(Comm\)](#) demonstrates.

The parties agreed to an expedited trial which later became a trial of preliminary issues, culminating in Phillips J’s ruling that a sale could not take place because there had been a failure to comply with the applicable right-of-first-refusal procedure.

Pre-emption rights may be raised at the last minute

The *Apache v Marathon* litigation initially concerned only the reasonableness of joint venture partners’ refusal to consent to the transaction, rather than pre-emption rights.

However, some weeks after the order for expedition, the defendants introduced last-minute amendments to rely on pre-emption rights, with Sir Jeremy Cooke allowing the amendments three weeks before trial. It was held that the pre-emption arguments had a real prospect of success and should be heard in the interests of justice: [Apache v Marathon Oil \[2017\] EWHC 2462 \(Comm\)](#), at paragraphs 12 and 15 (discussed in [The White Book 2018 \(Sweet & Maxwell, 2018\): Rule 17.3 – Amendments to statements of case with the permission of the court, 17.3.7](#)).

Exercising pre-emption rights, particularly late in the day, can generate a great deal of commercial leverage, because of longstop dates. However, contractual rights of pre-emption may also be subject to time limits, and it is

therefore important to be aware of precisely how and when a party can raise issues of pre-emption. The contract may prevent them from objecting to the transaction on that basis, or they may otherwise be estopped from doing so.

Estoppel may defeat pre-emption

A JOA will generally require the outgoing entity to tender a notice of assignment or transfer of interests. Pre-emption rights may be exercised following that notice, subject to compliance with any time limits, and subject to an estoppel precluding such exercise on the particular facts.

In *Dixon v Blindley Heath Investments Ltd* [2016] EWCA Civ 548, a party asserting pre-emption rights had by a course of conduct communicated its assumption that pre-emption rights did not apply. The assumption was shared by the counterparty and an estoppel by convention therefore precluded reliance on the pre-emption rights.

Accordingly, where a party objects to a transaction because of pre-emption rights, it is important to consider whether or not there might be a good plea of estoppel available.

Circumvention of pre-emption rights

In general, pre-emption rights in a JOA are not triggered by a transfer of an interest to an affiliate company (see *Hewitt and Daintith, United Kingdom Oil & Gas Law (Sweet & Maxwell, 2018): Chapter 6: Licence Operations: The Exploration Phase, 1-648* for a helpful discussion). A longstanding question for practitioners has been whether pre-emption rights can be circumvented by a sale of a transferee affiliate's shares.

Subject to express terms to the contrary, the better view is that it is permissible to transfer an interest to an affiliate and then sell all the affiliate's shares without triggering pre-emption rights. In *McKillen v Mislund (Cyprus) Investments* [2013] EWCA Civ 781, Moore-Bick LJ indicated that the way to avoid this circumvention would be to agree pre-emption rights which would apply on a change of control, rather than on a transfer of property (*at paragraph 134*).

This notwithstanding, Sir Jeremy Cooke took the view during the course of an interlocutory hearing in *Apache v Marathon Oil* [2017] EWHC 2462 (*Comm*) that there was a real prospect of success in the argument that pre-emption rights were triggered by a sale of an affiliate's shares even in the absence of "change of control" wording (*paragraph 15*). While this was not a final decision on the merits of the point and some have questioned the decision, parties should be aware that there remains some uncertainty in this area and the answer in any given case will turn on the wording of the contract in question.

Pre-emption provisions need not use clear words

In *United Company Rusal Plc v Crispian Investments* [2018] EWHC 2415 (*Comm*), Phillips J dismissed an argument that pre-emption provisions needed to use particularly clear words before they would be given effect (*at paragraph 52*). Phillips J upheld the rights of first refusal and clarified that previous case law did not require those rights to be strictly interpreted. It is therefore important not to approach pre-emption provisions on the assumption that there is any special or heightened onus on the party asserting them.

Notice of assignment or transfer may not be invalid even if contrary to pre-emption requirements

Not every JOA expressly states that compliance with pre-emption requirements is a condition precedent to the validity of a notice of transfer.

Where an agreement is silent on the consequences of failure to respect pre-emption rights, it will be for the court to discern the parties' true intentions about the consequences. In *United Company Rusal Plc v Crispian Investments*, Phillips J noted that a fresh notice could cure technical defects in an otherwise valid notice, but decided on the facts that the sale could not proceed for failure to respect the relevant right-of-refusal procedure (*paragraphs 78, 145 and 147*).

Pre-emption provisions not void for uncertainty if difficult to apply to particular facts

In *Texas Eastern v Enterprise Oil* (unreported), 21 July 1989 (*Court of Appeal*), which involved a dispute about a US\$901 million transaction, the Court of Appeal overturned a decision of Evans J which had found a pre-emption provision void for uncertainty. The problem was that the formula in the relevant provision could not easily be applied on its terms to the facts of the case, which involved three parties purporting to exercise their pre-emption rights simultaneously.

On an expedited appeal, Dillon LJ held that the appropriate apportionment depended on a formula which had not been set out expressly in the agreement. The decision turned on its unusual facts, but makes clear the importance

of thinking through how pre-emption provisions might apply where there are several pre-empting parties, or where interests in assets have changed over time.

TRANSLATING THE CASE LAW INTO PRACTICAL DRAFTING AND DISPUTE RESOLUTION TIPS

Drafting tips

- If selling an interest, consider whether the contract permits sale to an affiliate without pre-emption. Consider any definition of the word “affiliate” and whether the contract prevents circumvention of pre-emption rights by sale of a transferee affiliate’s shares.
- Consider raising the issue of pre-emption early on if acting for a seller. If the client’s position is that pre-emption rights do not apply, consider communicating this to the other parties sooner rather than later. This may help the seller to assert an estoppel if pre-emption rights later become an issue between the parties.
- Do not assume that pre-emption rights will be strictly construed against the party asserting them.
- Be alert to the fact that multiple parties may seek to pre-empt sales. Consider carefully whether changes in the assets and interests over time have rendered the pre-emption provision ambiguous.
- Check the contractual notice requirements carefully. If in doubt about the validity of the initial notice, consider serving a fresh notice to avoid time-limit problems later on.
- Be alert to the Master Deed in the context of a UKCS JOA:
 - in the UK, assignments of interests in oil and gas licences are generally made using the Master Deed. Where a pre-emption right exists in a JOA between companies who are also parties to the Master Deed, the pre-emption period is limited to 30 days from the date of service of a notice of the proposed disposal;
 - in *Apache v Marathon [2017] EWHC 2462 (Comm)*, Sir Jeremy Cooke held (albeit at an interlocutory stage) that there were reasonable prospects of success in the arguments that the Master Deed applied not only to field interest transfers but also to infrastructure interest transfers, and that the Master Deed applied to a sale of an affiliate’s shares.

For more information, see *Practice note, Oil & gas: assignment of an offshore licence: Assignment using the Master Deed*.

Dispute resolution tips

- Consider an application for expedition and make any such application as soon as possible. Bear in mind that delay can count against an applicant.
- Consider seeking declarations to establish the non-applicability of pre-emption rights.
- If the dispute raises no issues of fact, consider Part 8 proceedings (see *Practice note, Part 8 proceedings*).
- Where possible, identify narrow issues of law suitable for a preliminary issues trial.
- During litigation, consider the extent to which a fresh notice of assignment or transfer will remedy a pleaded defect.
- Ensure that all necessary parties are bound by the ultimate ruling.