SQUIRE PATTON BOGGS

Energy Transition and the End of the Production Sharing Agreement:

Dispute Avoidance

Introduction

With the energy transition in full swing, all oil producing majors, as well as many States, face mounting pressure from regulators and investors worldwide to develop clean energy and divest from fossil fuels. Many are acting accordingly.

At the same time, many fields are coming to the end of their economic life. The global decommissioning market is ramping up.

Operators and investors in oil and gas assets can find themselves unexpectedly at risk, as end of field life becomes a reality. Practical experience has demonstrated that certain reoccurring categories of risks exist once the end of field life becomes a reality.

To minimise liability and increase the chance of a favourable settlement and commercial agreement, it pays to stay alert and to pre-empt, prevent and prepare for claims and allegations, in particular, relating to:

(i) Environmental damage

(ii) Future abandonment and/or decommissioning costs

(iii) Maintenance and existence of project assets

(iv) Audit and cost recovery claims

Assessing Risks

You will need to identify likely areas of risk at an early stage.

Your document management and pre-handover actions should aim to mitigate these risks. At this initial stage, you need to take into account the following key points:

- Analysis of risks should be carried out together with your legal team, in order to be covered by privilege. Documents covered by privilege do not run the risk of falling into the hands of the opposing party if a dispute arises.
- Effective document management is key and will assist in dealing with any claims or allegations by the State. Your operational records need to:
  - Be accessible, well-organised and exhaustive.
  - Be user-friendly for those unfamiliar with the operations.
  - Be maintained securely and confidentially.
  - Be accessible outside the country of the operations, as access following departure may be difficult.
  - Include a register of all formal exchanges with key State authorities (such as ministries).
  - Be held in a system that allows for the capturing of correspondence sent to or from key officers and employees.
  - Be held in a system that allows for the filtering of materials involving legal advice and commercially sensitive information, such as exchanges with project partners.
- Key officers and employees will need to be bound by formal retainers. Staff who were substantially involved in the operations or the handover process may be called as witnesses when a dispute arises, and their evidence will be very important down the line.
- It is important to coordinate with other contractor parties, under the provisions of any applicable joint operating agreement.

Preparing for Environmental Disputes

It is not uncommon for allegations of environmental damage to arise. These allegations may arise at a stage where the assets have been passed to the State. Operators, therefore, often face problems with evidencing the nonexistence of alleged environmental damage, or that project assets have been properly maintained. To mitigate this risk, you need to maintain:

- Up-to-date and accessible records.
- A copy of the original environmental impact assessment, even if such were carried out before you came into the asset.
- Records of the environmental monitoring programmes and relevant reports.
- Proper records of your waste management activities.
- Proof that State/government authorities were involved in or aware of the above activities.

Preparing for Disputes Relating to Project Assets

In order to prepare for and mitigate the impact of disputes relating to project assets, it is important to prepare and maintain:

- A proper and detailed asset registry.
- Up-to-date maintenance records, which include your inspection and maintenance procedures.
- Records demonstrating the dates and results of past inspections and any maintenance work undertaken.
- Proof that State/government authorities were involved in or aware of the above activities.

Preparing for Abandonment and/or Decommissioning Disputes

Abandonment and/or decommissioning disputes arise in respect of three key types of assets:

- **Wells that have already been abandoned before termination** – The debate in relation to such wells often centre around whether they have been abandoned properly. The burden of proof for these allegations will normally rest on the State. In order to prepare and mitigate such disputes, maintaining records is important, especially in respect of records showing, among other things:
  - The steps taken to plug and/or abandon wells.
  - Whether abandoned wells are being monitored and the results of such monitoring.
  - The status of any abandoned wells at the end of the production sharing agreement.
- **Future abandonment of wells** – The debate in relation to such wells centres around which party will carry the burden of paying for abandonments that will take place after the operator has departed. This will largely depend on the terms of the relevant production sharing agreement. Without a provision stipulating that the operator is responsible for these costs, it is arguable that the State bears this responsibility.
- **Wells that have been suspended but not yet abandoned before termination** – It is important to maintain, on an ongoing basis, records that justify the decision to suspend rather than abandon the well, as well as proof that the State/government authorities approved or were aware of this decision.

Preparing for Cost Recovery Disputes

It is not uncommon for past and current audit claims to be raised at the end of a field's life. At this stage, the flexible stance typically taken during the course of the field's life tends to be discarded for a more dogmatic approach in order to reverse recovered costs. Such claims are often raised as leverage to settle other claims.

Cost recovery provisions are at the economic heart of a production sharing agreement. However, such claims are often resolved commercially. In this regard, a commercial decision to agree to certain audit exceptions may be made, irrespective of whether they are based on the contractual provisions.

The following can assist in preparing for and dealing with cost recovery disputes:

- Maintaining documentation that comprehensively explains the position on cost recovery. Any correspondence with the auditors needs to include well-reasoned explanations for the position taken.
- The burden to demonstrate that costs should not have been recovered is arguably borne by the State.
- The time at which costs were recovered may mean that a claim that they should be reversed is time barred. Most production sharing agreements will contain time limits for audits. The applicable law will also include limitation periods.

Depending on the provisions of the production sharing agreement, you may recover the funds set aside for decommissioning activities by way of the cost recovery procedure.

Settlement Discussions and Agreement

Settlement discussions will involve careful commercial considerations and trade-offs. To protect your interests and position:

- A member of the legal team should be actively involved in leading any settlement discussions. This will maximise the chance that documents will be protected by privilege and, therefore, cannot be disclosed to the opposing party in a dispute.
- You need to be careful in your communications. Even if you consider that a communication is protected against future disclosure, you should avoid making statements that would compromise your position in a dispute.
- The settlement agreement needs to be documented properly and stated to be comprehensive and final. The agreement should address each of the risk areas identified in your initial analysis, including:
  - Unresolved cost recovery audits.
  - Discrepancies in lifting allocation.
  - The condition of the block upon departure, particularly taking into account environmental and abandonment issues.
  - The condition and status of all assets, fixed and mobile.

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