Neutral Citation Number: [2019] EWCA Civ 11

Case No: A4/2018/0582/QBCMF

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES
MR JUSTICE KNOWLES
[2018] EWHC 322 (Comm)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 17/01/2019

Before :

LORD JUSTICE HAMBLEN
LORD JUSTICE HENDERSON
and
LORD JUSTICE GREEN

- -

Between:

(1) SPIRIT ENERGY RESOURCES LIMITED (FORMERLY CENTRICA RESOURCES LIMITED) **(2) TAQA BRATANI LIMITED** **(3) TAQA BRATANI LNS LIMITED**	**Appellants**
- and -	
MARATHON OIL U.K. LLC	**Respondent**

- -
- -

Paul Newman QC and Emily Campbell (instructed by **Mills & Reeve LLP**) for the **Appellants**
David Wolfson QC and Conall Patton (instructed by **Baker Botts (UK) LLP**) for the **Respondent**

Hearing date: 6th December 2018

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Approved Judgment

Lord Justice Green:

A. Introduction and overview

1. This is an appeal brought by participants in a joint venture operating in the oil and gas sector in the Brae Fields in the North Sea. The appellants are three such participants (the appellants or "the Participants"). The respondent is the operator but its affiliate is also a participant ("the Operator"). A fifth company (JX Nippon) is also a participant but is not an appellant.

2. The case is governed by two joint operating agreements. The first is dated 25th January 1980 and is entitled the "Joint Operating Agreement" ("JOA"); the second is dated 19th September 1990 and is entitled the "Unitisation and Unit Operating Agreement" ("UUOA"). For present purposes I focus upon the JOA which is, *mutatis mutandis*, identical to the UUOA.

3. The appeal concerns a short point of construction of the JOA. The issue can be summarised as follows: The JOA is said to be typical of operating agreements in the oil and gas exploration sector. In broad terms under such agreements one company is appointed as operator and has responsibility for conducting all operations. The operator acts on a "no profit/no loss" basis; the benefits and burdens of the venture are borne by other companies (the participants) who fund the operator and direct and supervise its operations. It may be the case (as here) that one of the participants is also the operator. To ensure that the participants exercise control over the operator, including its expenditure, an operating committee is instituted comprised of representatives of the participants. The operator submits draft operating programmes and budgets to the committee on a periodic basis but always in advance of the actual operations contemplated in the draft. The committee then reviews the programme and budget and approves or disapproves them, as the case might be. If the programme and budget are approved, then the operator is authorised to incur the necessary expenditure to implement the programme. Thereafter, the costs incurred by the operator are allocated as between the participants according to an agreed formula. In this way the operator is financially held-neutral and the participants share the benefits and burdens.

4. In the present case the Operator hired employees to work on the operation and this included offering them defined benefit occupational pensions as part of the remuneration package. The operations were approved by the "Operating Committee" instituted under the JOA. As matters turned out, due to macroeconomic volatility in interest rates, bond markets, equities etc, a substantial pension deficit arose, and this led to calls upon the Participants to fund the deficit. It is not said that at the time when the operations were first approved and authorised by the Operating Committee the precise nature and extent of the deficit was *then* foreseen.

5. The operations in question)including the cost of in-year employer's pension contributions) had however been the subject of prior approval by the Participants by reason of their inclusion in "*Brae Management Plans*" ("BMP") which under the JOA are prepared annually and include an operating programme and budget to cover the ensuing 12 months. When, subsequently, the deficit became evident for some years (as the Judge records in his Judgment) the Participants initially agreed to make

payments to fund the shortfall. However, they have now decided to make no further contributions.

6. The Operator argues that it is entitled under the JOA to *require* the Participants to pay their appropriate share of the pension deficit. Specifically, it seeks to recover an allocation percentage ("*the Brae Percentage*") of a deficit recovery charge ("DRC"). An actuarial valuation as at 31st March 2013 disclosed a funding deficit which was to be remedied by the DRC. The DRC as shown on a recovery plan dated 30th June 2014 exceeds £68m. The Operator argues that the Participants are responsible for 54.41% of the charge.

7. The Participants argue that, properly construed, they are not liable under the JOA and that, it follows, the Operator must bear those costs. They contend that under the JOA they are not required to pay for future liabilities which (in short) they never foresaw nor contemplated when the Operating Committee approved and authorised the programme and budget which included the employment of staff to work on the relevant operations.

8. If the appellants are right the practical effect is that the respondent (the Claimant, Marathon) in its capacity as Operator *and* Participant must alone bear the increased pension deficit even though the activities of the employees were directed at making profits for all the Participants. The appellants contend that this (ostensibly counterintuitive result) is not in actual fact an outcome inconsistent with the principles underlying the chosen method for allocating costs in the JOA. They argue this even though the principles governing allocation are expressly intended to apply equitably (as between Participants) and should not lead to the Operator making a profit or sustaining a loss (the hold-neutral principle).

9. By a judgment of 21st February 2018 ("the Judgment") Mr Justice Robin Knowles ruled on the construction of the JOA finding in favour of the Operator. He held that the Participants had approved the incurring of the disputed pension costs by virtue of the inclusion in BMPs of operations which were approved and the consequential expenditure authorised. They were therefore precluded from subsequently withholding approval and refusing to pay their allotted proportion of the DRC. This applied even if the extent of the deficit was not foreseeable at the point in time of approval of the peratins.

10. The Judge refused permission to appeal. Permission was subsequently given by Leggatt LJ on 10th May 2018 limited to a single ground relating to the liability of the Participants for DRCs. On this appeal the Participants seek a declaration that they:

> "… are not liable in respect of any part of the Deficit Recovery Charges in the absence of a (future) decision of the Operating Committee to that effect approving that part of the Deficit Recovery Charges as part of an operating programme and budget and (ii) that the members of the Operating Committee cannot be compelled to give that approval."

11. For reasons set out below I would dismiss the appeal.

B. The JOA

12. I turn to the JOA and to the scheme therein for the incurring of operating expenditure and the allocating of consequential costs as between the parties.

- *Right of Operator to conduct the operations / hiring of employees / pension arrangements*

13. Under Article 5.2 JOA the Operator was given exclusive charge and conduct of all operations under the "*supervision and direction*" of the Participants who approved (or rejected as the case might be) "*the operating programme and budget*" of the Operator:

> " 5.2 In accordance with approved programmes and budgets and under the overall supervision and direction of the Operating Committee, and subject to this Agreement, Operator shall have exclusive charge of and shall conduct all operations under this Agreement either by itself or by its duly authorized agents or by independent Contractors engaged by it.

14. Within this framework of supervision and direction, under Article 5.3 the Operator had the right to hire employees and to determine their terms and conditions, which included their pension rights:

> 5.3 Subject to the provisions of any approved operating programme and budget the number of employees of Operator employed in connection with operations hereunder shall be determined by Operator. The Operator shall determine the selection of such employees, their hours of work and their remuneration, and all such employees shall be employees of Operator exclusively.

It is clear from Section 2 of Exhibit A JOA that this included setting the pension entitlement of employees. This is not disputed.

- *Annual oversight by Operating Committee / prior approval of operating programme and budget*

15. The process of "*orderly*" supervision and direction was carried out by the Operating Committee. The creation of this committee was provided for by Article 6.1:

> "6.1 To provide for the orderly supervision and direction of [all operations conducted in accordance with the Agreement by or on behalf of any party with a Participating Interest], there shall be set up an Operating Committee composed of representatives of each [p]articipant. In exercising such supervision and direction, each representative on the Operating Committee shall act solely on behalf of the Party whom he represents and not on behalf of the participants as an entity. The powers and duties of the Operating Committee shall include:
>
> (a) determination of all general policies, procedures and methods of [operations];

> (b) consideration, revision and approval of all proposed operating programmes, budgets …;"

16. Article 7.2 JOA instituted a procedure whereby the actions of the Operator were subjected to an, in advance, system of authorisation and approval. The Operating Committee was under a duty to both "*agree*" and "*adopt*" an "*operating programme and budget*" for the Operator. This was to be done on an annual basis and in advance of the performance by the Operator of the matters authorised in the programme and budget:

> "On or before the 15th day of December of each year, the Operating Committee shall agree upon and adopt an operating programme and budget for the 12 month period beginning on the 1st day of January of the following year and for such further periods as the Operating Committee deems appropriate, which shall include as a minimum the work required to be performed under the Licence in respect of the Contract Area during such budget periods and the requirements of [the] Operator having regard to previously approved programmes and budgets and its obligations hereunder. At the time of agreeing upon and adopting an operating programme and budget, the Operating Committee shall provisionally consider, but not act upon or adopt, an operating programme for the calendar year next succeeding the period covered by such approved operating programme and budget."

The article identifies three broad matters to be agreed and adopted: (i) the work required to be performed under the Licence in respect of the Contract Area during such budget periods; (ii) the requirements of the Operator having regard to previously approved programmes and budgets; and (iii), the requirements of the Operator having regard to its obligations under the JOA.

17. The content of the draft operating programmes and budgets to be submitted by the Operator to the Operating Committee is governed by Section 6 of Exhibit A JOA which sets out accounting procedures and methods (addressed below). It is clear from this that the preponderant part of the information to be submitted comprised estimates backed up by assumptions, escalation factors and general contingency provisions. This reflects the fact that work and expenditure approved and authorised by the Operating Committee is, by its nature, uncertain and prone to change. An illustration is found in Section 6.4 of the Exhibit which required the Operator to include: "*An estimate of the timing and value of commitments under each main classification of costs, phased by quarter for the budget year and by year thereafter*".

- *Duty on Operator to pay all costs on a timely basis / provision of data and information to the Operating Committee*

18. The Operator is under a duty to use "*best efforts*" to "*diligently*" conduct all operations, including the duty to pay all costs and expenses incurred in the performance of its operations promptly and when due (Article 5.4(g)). This included (Article 5.4(l)) the duty to provide to the Operating Committee all relevant data and information:

"5.4 In the conduct of operations, Operator shall:

(a) use its best efforts to conduct diligently all operations in accordance with practices generally followed by the petroleum industry, to conform to good oil field and engineering practices and accepted conservation principles and to perform such operations in an efficient and economic manner. All operations shall be conducted in compliance with the provisions of the Licence and all applicable laws and regulations;

…

(g) pay all costs and expenses incurred by it in its operations hereunder promptly and when due and payable;

…

(j) obtain and maintain, in respect of the Joint Operations and the Joint Property, all insurance required under the Licence or any applicable law and such other insurance as the Operating Committee may from time to time determine, provided that, in respect of such other insurance, any [p]articipant may elect not to participate provided such [p]articipant gives notice to that effect to the other [p]articipants and does nothing which may interfere with the Operator's negotiations for such insurance for the other [p]articipants. The cost of insurance in which all the [p]articipants are participating shall be for the Joint Account and the cost of insurance in which less than all the [p]articipants are participating shall be charged to such [p]articipants in the proportion that each such [p]articipant's Participating Interest bears to the sum of the Participating Interests of such Participants. The Operator shall, in respect of any such insurances:-

(1) promptly inform the [p]articipants participating therein when it is taken out and supply them with copies of the relevant policies when the same are issued;

(2) arrange for the [p]articipants participating therein, according to their respective Participating Interests, to be named as co-insureds on the relevant policies with waivers of subrogation in favour of the Parties; and

(3) duly file all claims and take all necessary and proper steps to collect any proceeds and, if all the [p]articipants are participating therein, credit them to the Joint Account or, if less than all the [p]articipants are participating therein, credit them to the participating [p]articipants.

…

> (l) prepare and furnish to the Operating Committee such reports, statements, data and information as may be prescribed from time to time by the Operating Committee concerning [all operations conducted in accordance with the Agreement by or on behalf of any party with a Participating Interest];…"

- *The authorisation of expenditure by the Operator*

19. Article 5.5 conferred upon the Operator the power to make and incur all necessary expenditures to give effect to the (*ex hypothesi*) "*authorised*" operating programme and budget:

> "5.5 (a) Without prejudice to Article 5.5(b) [which dealt with emergency expenditure] the Operator is authorised to make such expenditures, incur such Commitments for expenditure and take such actions as may be authorised by the Operating Committee in accordance with the provisions of this Agreement."

- *The responsibility on Participants to bear costs incurred by the Operator*

20. Article 10.1 concerns the allocation of "*all"* costs and expenses of *"all operations*". These are to be "*borne*" by the Participants according to a proportion reflecting their interests in the operations. The language of the article is mandatory ("*shall be borne*") and connotes a duty or responsibility upon Participants to bear the Operator's costs; the language is inconsistent with the Participants having a power or discretion to decide <u>not</u> to bear the costs in question:

> "10.1 *All costs and expenses of all operations* under this Agreement in or in respect of the Contract Area or the Licence, including the handling, treating, storing and transporting, whether within or outside the Contract Area, of Petroleum produced from the Contract Area, and all costs and expenses properly incurred by the Operator in its performance of the relevant provisions of the Decommissioning Security Agreement except for costs and expenses which are solely attributable or relevant to a Party, *shall be borne by the [p]articipants in proportion to their respective Participating Interests from time to time except as herein otherwise specifically provided.* Furthermore, the costs of all assets, including materials and equipment acquired for the Joint Account of the [p]articipants shall be for the account of the [p]articipants in accordance with their Participating Interests from time to time, and, similarly, liabilities shall be borne in such proportions."
>
> (Emphasis added)

21. Article 10.2 is concerned with how these costs (to be borne by participants) are to be "*determined and settled*". This covers: "*All costs and expenses of whatsoever kind*

that are incurred in the conduct of operations under this Agreement". The allocation exercise is to be in accordance with the "*Accounting Procedure*" in Exhibit A:

> "10.2 All costs and expenses of whatsoever kind that are incurred in the conduct of operations under this Agreement shall be determined and settled in the manner provided for in the Accounting Procedure hereto attached and marked Exhibit A, which is hereby made part of this Agreement, and Operator shall keep its records of costs and expenses in accordance with such Accounting Procedure. In the event of conflict between the main body of this Agreement and the said Accounting Procedure, the provisions of the main body of this Agreement shall prevail."

Exhibit A: The principles governing the accounting for costs and expenses incurred by the Operator / the hold-neutral purpose

22. The way in which the Operator accounts for authorised expenditure is covered by Exhibit A. This is entitled "*Accounting procedure*". Article 10.2 (see above) provides that Exhibit A is a "*part of this Agreement*", and the Exhibit itself also expressly states that it is a part of the JOA. It provides that its terms apply save in so far as they are in "*conflict*" with the provisions of the JOA in which case the latter prevails.

23. The Exhibit starts with a statement of overarching "*purpose*". This has two substantive components. The first relates to the establishment of "*equitable*" means of determining charges and credits. The second establishes an Operator hold-neutral principle whereby the operation of accounting procedures is intended to prevent the Operator either making a gain or sustaining a loss.

> "The purpose of this Accounting Procedure is to establish equitable methods for determining charges and credits applicable to [all operations conducted in accordance with the Agreement by or on behalf of any party with a Participating Interest] under the Agreement and to provide that Operator neither gains nor loses by reason of the fact it acts as Operator. In the event of a conflict between the provisions of this Accounting Procedure and the provisions of the Agreement, the provisions of the Agreement shall control."

24. Section 2 thereof ("*chargeable cost and expenditures*") provides for the Operator to charge a "*Joint Account*" for all costs incurred in conducting operations. Such costs expressly include the "… *Operator's cost of established plans for employees' group life insurance, health insurance, pension*…". The relevant parts provide:

> "Subject to the provisions of the Agreement and the limitations herein after prescribed, the Operator shall charge the Joint Account for all costs incurred in conducting Joint Operations (for avoidance of doubt, any personnel engaged solely in training on the Joint Property for assignment to other operations shall not be considered as engaged in the conduct of

Joint Operations). Such costs include, but are not necessarily limited to the following: -

…

2 Labour and Associated Costs

A. That portion of salaries and wages of Operator's and its Affiliates' employees who are directly engaged in the conduct of Joint Operations, representing the portion of time spent by such employees directly engaged in the conduct of Joint Operations. To the extent not included in salaries and wages, the Joint Account shall also be charged with Operator's cost of holiday, vacation sickness, disability benefits and other customary allowances applicable to the salaries and wages chargeable under this paragraph in accordance with Operator's standard personnel policy in force in the relevant period.

B. A pro-rata portion of expenditures or contributions made pursuant to assessments imposed by governmental authority which are applicable to Operator's labour cost of salaries and wages chargeable under Section 2.2A.

C. A pro-rata portion of reasonable: business expenses, travel expenses, cost of living and housing allowances of those employees whose salaries and wages are chargeable under Section 2.2A and for which expenses the employees are reimbursed under Operator's standard Personnel policy enforce [sic] in the relevant period.

D. A pro-rata portion of any personal income taxes incurred by personnel whose salaries and wages are chargeable under Section 2.2A and reimbursed by Operator in accordance with Operator's standard personnel policy in force in the relevant period.

3 Employee Benefits

Operator's cost of established plans for employees' group life insurance, health insurance, pension, retirement, thrift, stock purchase, bonus, service and severance indemnities required by law or Operator's standard personnel policy in force in the relevant period and other benefits of a like nature applicable to the salaries and wages chargeable under Section 2.2A. However, the costs of any settlements for retirements and severance shall be pro-rated over those operations which the individual concerned served in the last three years of his/her employment, or, if less, over the period of employment with the Operator.

…

> 13 Other Expenditures
>
> Any other expenditures not cover [sic] or dealt with in the foregoing provisions which are incurred by the Operator or its Affiliates for the necessary or proper conduct of the Joint Operations."

C. The Judgment below

25. I turn next to the judge's conclusions. Certain facts were expressly or impliedly found by the Judge to be relevant context to the issue of construction arising. First, the Participants had approved the "*programmes and budgets*" of the Operator prior to the commencement of operations and annually thereafter as part of the annual BMP. Second, the employees were properly taken on and/or deployed to enable operations[1]. Third, the pension arrangements of the employees were properly agreed with them. Fourth, the Participants were aware of the possibility of a "*deficit arising*"[2].

26. The Judge (paragraph [20]) summarised the *modus operandi* of the scheme provided for under the JOA in the following way:

> "20. So far as material, this scheme was in my judgment as follows:
>
> (a) The Operator had charge of and was required to conduct all operations: see Clause 5.2.
>
> (b) The Operator was to pay all costs and expenses incurred by it in its operations under the Agreement: see Clause 5.4(g).
>
> (c) Subject to the provisions of any approved operating programme and budget the number of employees of the Operator employed in connection with operations was to be determined by the Operator: see Clause 5.3.
>
> (d) The Operator was to determine remuneration (and thus the pension arrangements that would form part of that remuneration): see Clause 5.3.

[1] Judgment paragraph [6]: "*There is no material dispute that the employees were required for the operations, or other than properly selected for employment, or as to any other aspect of the costs associated with their employment*."

[2] See Judgment paragraph [27]. See also paragraph [40]: "*The Agreements date from 1980 and 1990. The Participants (or their predecessors) were aware of the existence of the Scheme by 2003 and that it was a defined benefit scheme by 2004. They were aware that the Scheme was non-contributory and of its accrual rate. Lump sum payments into the Scheme were agreed by the parties in 2007 and 2008*." And see paragraph [42]: "*It is clear from the above that the Participants have long been aware of the essentials, and that the long history has included developments newly affecting the Operator and the Participants alike. The Participants have in fact made payments towards the Scheme deficit in more recent years, though now say they are entitled to claim these back (in full, and not simply where there has been overpayment). The problem today, and one equally faced by the Operator and affiliates, and many other companies, is that the continuing burden where there is a defined benefit scheme is very considerable*."

> (e) The Operator was to conduct all operations in accordance with approved programmes and budgets and under the overall supervision and direction of the Operating Committee: see Clause 5.2.
>
> (f) The Operator was authorised to make such expenditures, incur such Commitments for expenditure and take such actions as may be authorised by the Operating Committee: see Clause 5.5(a).
>
> (g) The Operating Committee was responsible for the orderly supervision and direction of operations: see Clause 6.1.
>
> (h) This would include: (a) determination of all general policies, procedures and methods of operations and (b) consideration, revision and approval of all proposed operating programmes and budgets: see Clause 6.1(a).
>
> (i) An operating programme and budget was to "include as a minimum the work required to be performed under the Licence in respect of the Contract Area during such budget period and the requirements of Operator having regard to previously approved programmes and budgets and its obligations": see Clause 7.2.
>
> (j) All costs and expenses of all operations under the Agreements in or in respect of the Contract Area or the Licence were to be borne by the Participants in proportion to their respective Participating Interests: see Clause 10.1.
>
> (k) The Operator was to prepare and furnish to the Operating Committee reports, statements, data and information: see Clause 5.4(l).
>
> (l) All costs and expenses of whatsoever kind that are incurred in the conduct of operations were to be determined and settled in the manner provided in the Accounting Procedure: see Clause 10.2.
>
> (m) The purpose of the Accounting Procedure was to establish equitable methods for determining charges and credits applicable to operations under the Agreement and to provide that the Operator neither gained nor lost by reason of the fact it acted as Operator: see Exhibit "A".
>
> (n) The Accounting Procedures envisaged that often estimation might be involved: see Exhibit "A".”

27. The Judge held that authorisation of the disputed pension expenditure flowed from authorisation of the operations, which included the hiring of employees and

accompanying pension provision. The approval of a budget at the point when payments under the pension arrangements were required in a particular year represented approval of the amounts that were payable in respect of a liability that had already been authorised. The Operator was correct in its submission that the Participants were in breach of contract when they refused to approve budgets on the basis of a contention that they bore no liability for the cost of the pension arrangements.

D. The appellant's submissions

28. I can summarise the broad outline of the arguments shortly. I address the more detailed arguments developed orally in section E below. It is said by the appellants that the Judge erred and that they are not liable in respect of any part of the DRC in the absence of an express decision by the Operating Committee to that effect approving that portion of the DRC which had formed part of an earlier BMP. This is so even though the Operating Committee had, earlier, approved the budget for the operations which gave rise to the pension costs (and which included provision for in-year employer's pension contribution).

29. The JOA broadly envisages only three specific types of expenses: (i) revenue items requiring the approval of the Operating Committee as part of the annual BMP process (and the DRC fits into this category); (ii) capital items requiring the approval of the Operating Committee as part of the special "authorisation for expenditure" or "AFE procedure"; and (iii) extraordinary items of necessity (eg relating to safety) which do not require approval. Under the JOA (Articles 5.5(a) and 6.1(b)) it is "*clear*" that the Operator is only entitled to reimbursement from the non-operating participants (ie all Participants save for the Operator) of such as costs as are "*specifically authorised*" by the Operating Committee. There are a number of reasons for this.

30. First, under Article 6.1(b) each representative on the Operating Committee was to act solely on behalf of the party that he represented and not on behalf of all participants as an entity. Moreover, the JOA does contain specific authorisation mechanisms for expenditure under Article 7 but this is directed at costs which are to be incurred during the 12-month period to be covered by the operating programme and budget, whether pursuant to obligations arising during that period or obligations arising under previously approved programmes and budgets.

31. Second, whilst it is accepted that remuneration in the context of Article 5.3 included pension benefits and permitted the Operator to fix the remuneration of its employees, it did not follow that the Operator was entitled to recharge the unforeseen pension deficit costs without being subject to the application of the provisions for approving operating programmes and budgets and, therefore, approval of those costs by the Operating Committee.

32. Third, even though no provision in the JOA compelled the non-operating Participants to reimburse the Operator for DRC in the absence of (after the event) approval by the Operating Committee, the Participants may of course "*choose to do so by reason for their commercial incentive in ensuring the efficient continuation of operations*." But they are not compelled to do so.

33. Fourth, there was nothing in the background knowledge, including the governing documentation of the pension schemes and/or section 224 Pensions Act 2004, which would have been available to the parties to indicate the existence of a requirement on Participants to bear such unforeseeable costs. There is nothing to suggest that these provisions were "*in the common contemplation of the parties at the time of the agreement*". When construing multi-party documents no account should be taken of a fact or circumstances known to only one party: see eg *Arnold v Britton* [2015] UKSC 36 ("*Arnold v Britton*") at paragraph [21] per Lord Neuberger. And in any event at no relevant point in time was there any statutory basis for the liability of employers in relation to deficiencies in pension scheme assets

E. Analysis

34. I do not accept the submissions of the appellants. There is no dispute between the parties that the principles of construction arising are those set out by the Supreme Court in *Arnold v Britton* and in particular in the judgment of Lord Neuberger at paragraphs [14] – [23].

35. The starting point is the "*natural and ordinary meaning*" of the contractual language of the JOA (*Arnold v Britton* (ibid) paragraph [15]). This can be considered from the perspective of (i) the individual clauses which impose liability upon Participants; (ii) the JOA as a whole and inferences drawn therefrom; and (iii), a purposive construction of the JOA taking into account and applying the principles which the parties have expressly incorporated into the agreement in Exhibit A namely equity as between Participants and holding the Operator neutral in relation to both gains and losses.

36. I start with specific provisions which impose liability upon the Participants for costs incurred by the Operator. Under the scheme set up under the JOA once the operations and budget have been approved on an annual basis by the Operating Committee the Operator is entitled (authorised) to charge the related costs to the Joint Account and these costs are then to be borne by the Participants. It is not in dispute but that the DRC was a cost which was consequential upon the prior approval by the Operating Committee of the operations. Several articles in the JOA make clear that the Participants are required to pay the pensions costs.

37. First, Article 7.2 (see paragraph [16] above) imposes an obligation ("*shall*") on the Operating Committee to "*agree upon and adopt*" the Operators requirements "*having regard to*" previously approved programmes and budgets. The phrase "*requirements of Operator"* in Article 7.2 refers to those matters the Operator was required to perform under prior operating programmes and budgets and would include the costs thereof. The use of the phrase "*having regard to*" is not a qualification of "*requirements*". It is an instruction as to the source of the requirements, namely prior approved programmes and budgets. I do not accept the argument that it serves to confer a discretion upon the Participants to choose which "*requirements*" they honour and which they do not. That is a strained construction of the language and is inconsistent with the other express provisions of the JOA including principles guiding the allocation of costs set out in Exhibit A (see below).

38. Second, Article 10.1 concerns "*all*" costs and expenses of "*all*" operations and stipulates that they "*shall*" be "*borne*" by the Participants. Again, the language used

is mandatory and not discretionary. In context it relates to the costs and expenses of authorised and approved operations and as such covers the DRC which arose out of terms and conditions of employment which the Operator entered into with employees. Nothing in Article 10.1 differentiates between different types of cost and, in particular, whether they are uncertain as to scope and extent as of the date of approval and authorisation.

39. Third, Article 10.2, which governs settlement of costs as between Participants, refers in the broadest possible terms to "*all costs and expenses of whatsoever kind that are incurred in the conduct of operations".* It goes on to provide that these *"shall be determined and settled in the manner*" set out in Exhibit A which is a part of the agreement. The article is mandatory ("*shall*") and, as with Article 10.1, is all-encompassing. This is confirmed by "*all*" and reinforced by the phrase "*of whatsoever kind*". There is nothing in the contractual language which carves out costs the full nature and extent of which was unknown and/or unknowable at the point in time when the head of cost was first approved and authorised. Under Section 2 Exhibit A the Operator "*shall*" charge the Joint account for "*all costs incurred in conducting Joint Operations*".

40. Fourth, a further matter which, according to *Arnold v Britton*, should be considered, is the "*overall purpose of the clause and the [agreement]*" (*ibid* paragraph [15]). In the present case this task is rendered straightforward by the express inclusion in Exhibit A of the relevant purposes, namely an equitable allocation of costs and benefits as between Participants, and an Operator hold-neutral principle. As already observed these lead to the conclusion that the Participants are liable for the DRC. When the draftsperson of a contract goes to the length of explicitly setting out guiding purposes to facilitate purposive construction it is incumbent upon the courts to attach weight to that expression of common purpose. The hold-neutral purpose supports the conclusion that nothing in the accounting procedures should lead to the Operator bearing a loss. The principle of equitable distribution applies to "*charges and credits*" ie burdens and benefits and covers costs, such as pensions costs. This is consistent also with Article 2.1 JOA which is an introductory provision concerning effective date, term and scope. It is stated there that the JOA remains effective until there is a "*final settlement*" as between Participants and "*to the end that each of the Participants shall have shared all benefits and burdens* …" in accordance with the agreement. The reference to "*burdens*" would include unexpected pensions costs.

41. In short, the normal and ordinary meaning of the JOA, including by reference to its purpose, compels the conclusion that the Participants must bear the DRC.

42. I turn next to the overarching commercial purpose or "*commercial common sense*" (*Arnold v Britton* (ibid) paragraph [17]) of the scheme. In one sense there is no need to have resort to commercial common sense or rationale since the JOA itself, in setting out its guiding purposes in Exhibit A, has identified by what criteria the commercial rationale of the JOA is to be measured. Nonetheless, Mr Newman QC advanced a different commercial rationale to that in Exhibit A. He advanced two main arguments.

43. First, he contended that a construction of the JOA that could lead (and in the present case has led) to an impasse with neither the Operator nor the Participants agreeing to bear the unexpected costs, was unproblematic since, in practice, when such a situation

arose it would lead to negotiation and agreement as between the parties addressing the future liabilities. Before the Judge the appellants argued: *"[the Participants] may argue that the volatility of the Scheme's funding should be reduced (by closing the [defined benefit] scheme and switching employees to a [defined contribution] scheme or a group personal pension arrangement); [the Operator] may argue that that would be a false economy, as a [defined benefit] scheme is vital to the recruitment and retention of key staff; but the point is that this would be dealt with by negotiation and agreement, perhaps leading to the amendment of the Agreements*." This argument was essentially repeated by Mr Newman QC before us. I disagree. It is not in my view a commercially sensible construction of a joint operating agreement of this type to leave such an important issue as who bears the costs of operations to be resolved though the inherently uncertain mechanism of future negotiations, an agreement to agree. If this had been the intention of the parties upon contracting, then they would surely have said so. But instead they chose the sensible mechanism of prior approval of the Operators "*programmes and budget*s" as the means by which they supervised and expressed approval of related expenditure by the Operator which they would, under the JOA, be required to bear in the future. Indeed, the present dispute is signal proof that the appellants argument does not lead to commercial reconciliation. It has not been settled. The intention of the appellant Participants is to make the Operator and their fellow Participant (Marathon) pay <u>all</u> the costs of the DRC. The facts speak for themselves.

44. Second, Mr Newman QC argued that there was commercial logic in the Operator being held liable for the DRCs because it had always been open to the Operator to take steps to ameliorate pension liabilities and they should be held responsible for their failure to curb these runaway costs. It was accordingly fair and commercial that Participants should not be compelled to bear such costs. Again, I disagree. The rationale behind the Operator being required, annually, to spell out its future operating programme and budget accompanied by relevant estimates, assumptions and contingences is to enable the Operating Committee to consider, and if appropriate, revise and then approve or disapprove the budget. If the budget is approved then the Operator is authorised to incur the expenditure. Having exercised this judgment call and expressly authorised the operations the Participants assume responsibility for those liabilities and cannot argue that it is the fault of the Operator. To apply their own argument, it is <u>their</u> decision of approval and authorisation that is at fault, and not that of the Operator.

45. Mr Newman QC also argued that, applying *Arnold v Britton* (ibid), provided parties to a dispute could advance rival commercial rationales then one cancelled out the other. Once again, I do not agree. Not all arguments are equal. In this case not only do I find the Participant's purported rationale to be counterintuitive and lacking in commercial logic but, more importantly, the optic through which to construe the JOA is that decided upon by the parties themselves and articulated in Exhibit A. There is no identifiable logic whereby the Participants can take the benefits but avoid the risks. On the appellant's analysis having approved the Operator's operations and its budget, and thereby induced the Operator to expend money including on pensions, the Participants, or each of them according to their own narrow self-interest, can refuse to agree to pay (bear) their allotted portion of the costs leaving the portion they would otherwise bear to be borne by the Operator (who also happens to be a Participant). Indeed, Mr Newman QC for the appellants accepted that if his analysis of the JOA

was correct they were entitled to compel their fellow Participant, Marathon, *qua* Operator, to bear the full costs of the DRC. They could take the benefit but none of the burden. With respect I was unpersuaded that this could ever be considered commercially rational in the context of an agreement of this sort.

46. I turn now to address various other arguments advanced by the appellants, advanced to counter the construction placed upon the JOA by Mr Wolfson QC for the Operator.

47. Mr Newman QC argued that the analysis of the Judge served to confer upon the Operator the ability to write a "*blank cheque*" implying that the Operator could spend the Participants money with impunity and without control or protection. But this is not so. It might be true that under the JOA the Operator is given a blank cheque, but:

a) The Operating Committee, fully appraised of the relevant facts, formed a judgment that the Operator should be granted this freedom and they authorised the expenditure in question and, in effect, agreed to underwrite the bill. Cheques written by the Operator to cover operating expenses and costs, including in relation to future pension costs, were consequential upon operating programmes and budgets expressly authorised by the Participants *via* the Operating Committee.

b) It was in the nature of the operations that the authorisation covered costs which might, at the time of approval, be uncertain as to their scope and nature. This was why Exhibit A, Section 6, required detailed information as to estimates to be provided to the Operating Committee. To the extent that the liabilities were much larger than expected, this did not alter the underlying analysis. The Operator was authorised to write a cheque to cover pension payments, *whatever* they might turn out to be.

c) Finally, to the extent that the Participants needed protection they obtained it from the common law. They would not be liable for any cheque written by the Operator in bad faith or dishonestly. Before the Judge there was debate as to the nature and extent of the duties of the Operator. The Operator accepted that where the JOA conferred a contractual discretion it was under an implied duty to exercise that discretion genuinely, honestly and in good faith (see *Socimer International Ltd v Standard Bank London Ltd* [2008] EWCA Civ 116). The Participants argued that the Operator was in the position of a fiduciary and for that reason, but also upon the basis of the admitted implied contractual duty, owed a duty to act in good faith "*such good faith importing the requirement of fair and open dealing*". The Judge did not express a definitive view on the merits of the competing formulations of the duty of the Operator albeit that he preferred the test as set out by the Operator (Judgment paragraph [38]) but either way it shows that the appellants' construction of the agreement is not necessary to enable it to impose a duty upon the Operator to act with propriety. A combination of the Participant's right and ability to exercise prior approval coupled to the accepted duty of the Operator to act genuinely, honestly and in good faith undermine any argument that *ex post facto* approval was necessary or made business sense and that it

was irrational to construe the JOA as authorising the Operator to write blank cheques

48. Next, Mr Newman QC argued that if the Operator's argument on Exhibit A, and the principle that the Operator was held-neutral, was to be accepted it had the consequence that if the pension scheme had (hypothetically) been in surplus (as opposed to deficit) then by rights the Operator would have to transfer the surplus to the Participants. He argued that the JOA did not however so provide for this which, he said, was a clear indication that properly construed the hold-neutral provisions in Exhibit A of the JOA were not as absolute as was suggested and should not be accorded substantial weight as a guide to the construction of the JOA. Mr Wolfson QC, for the Operator, objected that this was a new and unheralded point but his immediate (provisional) reaction was that under the JOA the Operator "*might*" be liable to account for surpluses. In other words, the hold-neutral provision might permeate throughout the whole of the JOA. The point was not subjected to full argument and is of possible complexity in particular as to what in law can be done with pension surpluses. I do not express any sort of a conclusion on the matter. I would observe only that the issue does not seem at first blush to be as clear cut as Mr Newman QC submitted:

(i) The particular terms of the JOA arising in this appeal are concerned with the "*costs and expenses*" incurred in the performance of operations (eg Article 10) ie not benefits or surpluses; as such the point is hypothetical. Other provisions deal with "*credits*" which might arguably include surpluses, though we heard no argument upon the meaning of this word.

(ii) The spectre raised by Mr Newman QC of a durable surplus seems improbable given that the Operating Committee has the power annually to revise budgets (under Article 6.1(b)) so that if a surplus is identified it can be accounted for or addressed annually. Under Section 1.4 of Exhibit A the Operator is required to produce frequent statements of expenditures which include "*credits received by the Operator on behalf of the Joint Account*". The principles governing accounting procedures (in the preface to Exhibit A and in Section 1.2) also expressly covers "*charges*" and "*credits"* applicable to "*Joint Operations*", which as defined covers the conduct of the Operator. It is accordingly arguable that surpluses are to be part of the annual budgetary approval process. Such a conclusion would at least be consistent with the commercial logic and purpose behind the JOA.

(iii) If a surplus exists when the JOA came to its end then, as reflected in Article 2.1, the agreement continues until there has been a <u>final</u> settlement and reconciliation of accounts as between the Participants and, according to the contractual language "… *to the end that each of the Participants shall have shared all benefits and burdens … in accordance with their respective Participating interests*…". The reference to the final account taking account of "*benefits*" is, again, arguably broad enough to include the allocation of surpluses. Standing back Exhibit A reflects the principle that Participants enjoy

benefits and bear burdens. Again, on this basis any surplus would in the final reckoning be paid to the Participants *pro rata*.

(iv) If on fuller analysis the JOA does not, however, address surpluses then we heard no argument as to whether a term might be implied to deal with the matter.

49. I would mention two final matters. First, Mr Wolfson QC for the Operator relied upon Article 5.7 JOA which grants an indemnity to the Operator. He argued that if he was wrong as to his primary argument about the construction of the JOA then he relied upon this clause as plugging the gap and imposing a duty upon the Participants to indemnify the Operator. For the reasons given above I do not consider that the argument arises and I express no view on the scope and effect of this clause. Second, in the Respondent's Notice the Operator advanced an argument based upon facts said to be unchallenged and/or common ground. The Operator explained that it gave presentations to the Operating Committee in relation to the pension deficits on various dates (September 2003 - February 2008) which covered the need to make top-up payments in respect of the pension deficit. When the Judge dismissed the Participant's counterclaim for alleged breach of fiduciary duty, he held that a reasonable observer would conclude that the Participants had given their authorisation and consent to expenditure on the pension scheme. It followed that the Participants were fully cognizant of the fact that pension deficits had been identified which they would be required to contribute to and, moreover, the Participants had paid their share without complaint until 2014. The Operator argued that, even if its primary argument about the scope of the JOA was not accepted, the Participants in actual fact approved the pensions costs in issue. As to this argument I am doubtful whether this is a true Respondents Notice point since it raises a series of issues tied to the facts of the case about which the Judge did not express views. Moreover, it is not necessary to address this point given my conclusion on the main arguments and, again, I prefer to express no view about it.

F. **Conclusion**

50. For the above reasons I would dismiss this appeal

Lord Justice Henderson:

51. I agree.

Lord Justice Hamblen:

52. I agree.