

Case Studies on Dispute Prevention
(Oil and Gas Exploration Case Study)
(prepared 2021)

Description of parties:	Operator, a constructor of pipelines, and Producer, which engaged in oil and gas exploration.
Brief history of relationship and arrangement:	<p>Producer and Operator sought a business relationship in which Operator would build a pipeline to Producer’s production site. They agreed that there could be opportunities to build adjacent pipelines to other producers in that region, which would stem from this original system. In light of the value that Producer’s initial pipeline would bring, the parties agreed to form a joint venture to own and operate it. Producer signed an agreement with the JV under which it would make a long-term commitment to use the system to ship its product. Under the JV agreement, Operator would control the JV. The JV agreement included optional and mandatory funding provisions. It also included detailed provisions to govern new opportunities to build adjacent pipelines from the original system, whether the JV would have the right to take those opportunities or whether the partners could pursue them, and if the JV were to take those opportunities, how those would be funded.</p> <p>When times were good and commodity prices were stable, the Producer had a keen interest in the JV as a way to recover the economic benefit it brought to the JV through its original agreement and production volume. But as commodity prices declined and that producer’s financial stability suffered, it had less of an interest in co-funding new expansion projects for the JV.</p>
Nature of issue, conflict, or dispute:	<p>A dispute arose over a new expansion project. Operator and Producer disagreed as to whether the board of the JV had resolved to build that expansion system and how to fund it. At this point, the original relationship leaders (who were board members) were no longer involved with the JV, and their successors had a limited history of working together. This added to the challenges of resolving the dispute.</p> <p>Before the dispute ripened, the JV had initiated development of the expansion system and incurred commitments and costs to do so. A funding failure would have made it difficult for the JV to honor some of those commitments, which could have caused the JV to incur penalties and possibly disputes with suppliers and contractors.</p> <p>The JV agreement had a customary dispute resolution provision that called for litigation in state court.</p>

Nature of dispute prevention mechanism deployed:

N/A

How was the actual or potential conflict or dispute prevented or resolved?

Each party threatened litigation. The principals eventually negotiated a solution under which each agreed to some additional equity funding for the expansion project, the Producer would have an option to contribute additional funding and if it declined to fund, then at each stage the Operator would have the right to fund additional amounts or bring in third parties to contribute capital. The provisions for valuation at each funding stage (which would affect dilution of the non-funding parties) were heavily negotiated.

If none deployed, nature of dispute prevention mechanism that might have been deployed:

The parties would have benefitted from a mediation requirement, or a typical escalation-to-senior-executives mechanism. Either of these would have forced discussions of their impasse to begin earlier

Lessons from the case study:

Parties who decide to depart from their established JV governance process should document the changes and consider whether they will be adequate to resolve disputes.

In this case, the JV agreement's process for evaluating and funding new opportunities was clear. However, over time the parties had developed a course of dealing at the board level that departed from that process. That course of dealing had an element of informality that served the parties well for many years. After the parties resolved the dispute, each party was much more careful about documenting its commitments and what it understood to be the commitments of its counterpart.