

INSIGHTS

Negotiating PSCs - The Dangers of Using Intermediaries

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In *Monde Petroleum SA v WesternZagros Ltd* [2016] EWHC 1472 (Comm), the English Commercial Court has found that a party to a consultancy agreement can become liable for the misrepresentations made by a third party intermediary.

Parties negotiating production sharing contracts ("PSCs") in regions emerging from politically unstable periods will regularly seek the assistance of local third party intermediaries in order to lobby the relevant political decision makers to get the deal done. Whilst it is a fairly common practice, this case highlights the dangers inherent in dealing with third party intermediaries in circumstances where their allegiances are unclear. In this case, the Judge looked behind the façade presented to the court to establish the true nature of the relationships between the parties.

Background

The case centres around the period following the fall of Saddam Hussain and the attempts by Western companies to explore for and develop the natural resources of the Kurdistan region of Iraq. The claimant in the action, Monde Petroleum ("Monde"), is a British Virgin Islands company run by Mr Yassir Al-Fekaiki ("Mr Al-Fekaiki"), a British national of Iraqi origin. The defendant ("WZL") is a Cypriot-registered company with its headquarters in Calgary, Canada.

In early 2006, WZL was attempting to negotiate a PSC with the Kurdistan Regional Government ("the KRG"), with a view to exploring for and developing oil production in that region of Iraq. At around this time, WZL was in contact with Mr Bafel Talabani ("Bafel"). Bafel is the son of His Excellency Jalal Talabani, who was the President of Iraq from April 2005 to April 2014. Bafel introduced WZL to Monde, who subsequently entered into a written agreement for consulting services with WZL (the "CSA"). The services under the CSA were to be provided by Mr Al-Fekaiki, and were intended to assist WZL to conclude its PSC negotiations successfully. Fees were payable by WZL to Monde under the CSA and Monde was also granted an option to acquire a 3% interest in the PSC if certain stipulations were satisfied. In March 2007, WZL sought to terminate the CSA by service of a Termination Notice. However, the Termination Notice did not give the 30 day notice period required under the CSA. Following subsequent discussions with Bafel, Monde signed a Termination Agreement bringing the CSA to an end.

In the Commercial Court proceedings, begun on 4 March 2013, Monde claimed that its signature to the Termination Agreement was procured by misrepresentations made on behalf

of WZL by Bafel. Specifically, Monde asserted that Bafel represented to Mr Al-Fekaiki in the course of a series of telephone conversations that, if Monde agreed to sign the Termination Agreement, WZL would not merely pay the fees for which Monde had invoiced WZL, but would also enter into a new agreement under which Monde would be given the chance to share in the profits arising from WZL's oil exploration and production in Kurdistan. Monde asserted that it relied upon these representations, which were false, and signed the Termination Agreement.

Decision

Mr Richard Salter QC, sitting as a Deputy Judge of the High Court, began his analysis of the issues in the case by considering the true nature of the relationships between Mr Al-Fekaiki and Bafel, and between WZL and Bafel. The absence of evidence from Bafel meant that it was necessary for the Judge to infer the nature of the relationships between Bafel and each of the parties. Although on its face Bafel had no direct financial interest in the CSA, the Judge found that there was a separate underlying agreement between Mr Al-Fekaiki and Bafel such that Monde had to account to Bafel for the majority of the amounts paid by WZL to Monde. Thus, Bafel had relevant relationships with both Monde and WZL. There was subsequently a cooling of the relationship between Bafel and Mr Al-Fekaiki in early 2007, at around the same time as WZL was being pressed by the KRG government negotiators to terminate arrangements with all third parties (in addition to Monde's 3% option, WZL had granted two other parties options in respect of its interests) and to take a "local partner" satisfactory to the KRG. The Judge found that Bafel would have seen he was no longer likely to receive anything via Monde from WZL and so was looking to set up an alternative "local partner" deal with WZL under which he could continue by other means to get an indirect cut from WZL's profits. Accordingly, it was the Judge's view that Bafel did indeed make the misrepresentations alleged by Monde to Mr Al-Fekaiki on which the latter relied in agreeing to sign the Termination Agreement.

The Judge then considered whether Bafel made the misrepresentations on behalf of WZL. There was no direct evidence, whether oral or documentary, to prove that, in making the representations, Bafel was acting on behalf of WZL. Monde's case was a circumstantial one and it was directly contradicted by Mr Hatfield's evidence that Bafel had no such authority. In reaching his conclusion, the Judge found that WZL's evidence was unsatisfactory, not credible and selective. He emphasised that the conferring of authority did not have to be proved by direct evidence and could be inferred from circumstantial evidence, including things said by the intermediary to Monde. Having looked in detail at the contemporary documents, the Judge found that it was more probable than not that, in the early part of 2007, Bafel was trying to negotiate a new arrangement with WZL that would be profitable for himself, and that, in the course of those negotiations, WZL asked Bafel to "clear the decks" by getting Mr Al-Fekaiki to sign the Termination Agreement on behalf of Monde. He therefore found that, in making representations to Mr Al-Fekaiki, Bafel was acting at WZL's request and therefore with WZL's actual authority. He was not acting either on his own behalf, or on behalf of Monde.

However, although the court found that Monde was entitled to damages as a result of WZL's misrepresentations, this ultimately did not assist Monde as the court held that WZL caused Monde no substantial recoverable loss. Although the Termination Notice was not effective to bring the CSA to an end because it did not give the 30 day notice required by the termination for convenience clause, the court held that it would nevertheless have been open to WZL, at any point thereafter, to serve an effective notice under the termination clause and any damages recoverable by Monde from WZL must therefore be assessed on that basis.

Comment

This case acts as a reminder to parties, particularly oil and gas companies, who are considering using intermediaries to assist them to conclude PSCs or other agreements with the government, especially in politically unstable regions. The particular point to note is that circumstantial evidence alone can result in liability attaching to the principal in respect of the words or actions of those intermediaries. Clear boundaries of authority are therefore critical in establishing the role of any intermediary and its ability to represent the principal.

What is also striking about the case is the fact that neither party to the litigation called Bafel to give evidence as to whether he was authorised or not to make the relevant representations. The only direct witness evidence regarding the third party intermediary's authority or otherwise to make representations on behalf of WZL was to the effect that the intermediary had no such authority. The Judge took it on himself to look behind the façade to uncover the true nature of the relationships between the parties in finding that Bafel's allegiances shifted significantly over time to the point that he became, in effect, authorised to make representations on the part of WZL.

Parties should also note the economic impact of the case. Although there was a finding of liability for WZL, no damages were awarded to Monde due to the existence of a termination for convenience provision. This finding emphasises the importance of properly drafted and carefully considered termination clauses in commercial arrangements.