The Metropolitan Corporate Counsel®

www.metrocorpcounsel.com

Volume 20, No. 10 October 2012

Behind The Scenes Of An Oil And Gas Practice

The Editor interviews ***Scott Schwind****, Partner in the Houston office of Jones Day.*

Editor: Please describe your practice area.

Schwind: I am an international oil and gas transactions lawyer. In plain English, that means that I help clients buy and sell oil and gas producing properties and develop those properties. I draft and negotiate concession contracts, production-sharing contracts, joint operating agreements, farm ins and drilling contracts – all of the nuts-and-bolts-types of contracts that we see in the oil and gas industry. I also frequently document midstream transactions – basically, the means by which oil and gas resources are conveyed from where they're produced to the marketplace, including pipeline transportation, LNG throughput and deficiency, and crude oil refining and processing arrangements. I sometimes get involved with downstream transactions, such as the trading and marketing of crude oil and refined products. I've also been very active throughout my career in drafting contracts to build infrastructure assets for the oil and gas industry, such as EPC contracts and O&M agreements for drill ships, rigs, pipelines, platforms and FPSOs.

Throughout my career, most of the transactions that I have worked on have been international, primarily in Latin America but increasingly in Africa, but over the last few years I've done probably more deals in the United States than at any other time. That trend simply reflects the fact that there has been a tremendous amount of activity on an incredible scale in the U.S. shale plays.

Editor: In what countries do you find the most activity in oil and gas extraction, and what conditions account for that activity?

Schwind: For the last couple of years, the amount of activity that we have seen in the Western Hemisphere has been amazing. We have seen a tremendous number deals in Canada and the United States, because of the shale developments, even while offshore activity in the U.S. Gulf of Mexico has been down. Brazil obviously is a country where there's been significant upstream activity, as well as Colombia, Peru, and even Suriname and Guyana.

Scott Schwind

This can be attributed to a number of factors, the first being the availability of the technology and know-how necessary to reach resources that were previously thought to be unavailable. Shale oil and shale gas are wonderful in that there is very little of the exploration risk that you would typically see in a conventional oil or gas play, and if you have the technology to seek out shale resources, you are generally assured that you're going to be able to actually produce oil and gas in commercially viable quantities. I think the boom in shale exploration also owes something to the fact that the activity is on the home turf of many U.S. oil and gas companies.

The second factor is that the activity in the Western Hemisphere is generally taking place in countries that are politically stable and friendly towards the oil and gas industry. The combination of abundant resources and governments that are generally friendly towards the oil and gas industry and towards foreign investment means that it's just easier for U.S. companies to stay closer to home than to invest in, say, a major offshore development off the coast of a distant country that may be politically unstable. In the time that I've been involved in the oil and gas industry, I've never seen the activity level in the Americas as high as it has been consistently over the last three or four years.

Editor: Describe your role in coordinating foreign and domestic oil and gas transactions of various kinds.

Schwind: What I do in any given deal depends on the deal itself and also on the client. As lawyers, we help our clients get their deals done according to the clients' specific needs – sometimes, that means quite a bit of handholding, issue spotting and even taking a lead role in negotiations. Sometimes, however, my very sophisticated clients don't need anything more than a draftsman and a sounding board for ideas. In every deal, though, I help my clients identify risks and formulate strategies to manage those risks. Since oil and gas deals can have significant environmental, financial and regulatory and political implications, I think the help that we provide to our clients in allocating and managing risks is really one of the most important things that we do.

Editor: Why is the role of the lawyer important in oil and gas transactions?

Schwind: The lawyer sometimes helps to manage the buoyant optimism of the members of the business team, who are often tremendous advocates of the deal and who sometimes see very little potential downside to getting the deal done as quickly as possible. In that sense, the lawyer is the voice for the company itself and looks out for the best interests of the client, not necessarily the best interests of the deal. Getting the deal done is important, though, so in addition to helping the client identify risks, the lawyer really helps the client to structure the deal in a way that successfully overcomes those risks and limits the downside of the deal.

Editor: What types of documents are critical in joint venture, production-sharing agreement, joint operating agreement and joint development agreement transactions?

Schwind: The documents tend to vary from deal to deal, as you might suspect, but one of the common themes that we see is that the time, effort and energy that the deal team puts in on the front end is absolutely critical to how a deal develops. In other words, the planning and attention to detail that go into

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drafting and structuring a joint venture agreement, a JOA or a JDA can pay huge dividends throughout the life of the implementation of that deal. We've seen many, many cases where clients or their counterparties have not focused on issues in the documentation that later became big areas of controversy.

At the end of the day, the specific documents that you asked about all have the concepts of "joint" and "sharing" in common. That means that you're talking about a deal between two or more parties. How do you marry the interests that those parties have in getting the deal done when there are areas in which some of their objectives and policies compete or even conflict? It can be a tremendous challenge to harness the efforts and energies of parties with different agendas and different cultures to work together. I think it's all about trust, and properly structuring the deal documents can help to develop that trust. It simply means that the parties can have confidence that they're all playing on a level playing field.

Editor: More joint ventures have fallen apart than have stayed together.

Schwind: I think that's right. One of my common philosophies is that people are all by nature somewhat dysfunctional, and companies are nothing but groups of people, so companies are dysfunctional too. Just like any relationship between two people or two groups of people, a joint venture is full of challenges, so it isn't surprising that many of them fail. Of course, in an international setting, you add different cultures, language barriers and even historical baggage between people from different countries, all of which can create additional complexity and opportunity for conflict.

Editor: What clauses in the documents relating to exploration and production agreements tend to vary the most, depending on the country in which the project takes place? Are there any fail-safe provisions that provide for adequate compensation in the case of expropriation?

Schwind: At the end of the day, tax issues are the proverbial tail that wags the dog, and they often drive much of what the deal looks like – so much of structuring is put in place to take advantage of any favorable tax treatment or to plan around tax challenges. Perhaps more than any other issue, I think that is the driver that leads to the most variety in deals. In addition, international oil and gas deals usually involve the foreign sovereign government or the foreign state oil company as an investor, as a regulator and/or as a party to the contract, so a lot of the provisions of these contracts are often shaped by the terms of an underlying deal with the sovereign government. For example, if your client has a concession contract to develop an offshore block, and the client has agreed to partner with two or three other entities to develop that block, then your client and its partners will enter into a joint operating agreement that will be very strongly affected by the terms, conditions and requirements of the underlying concession contract.

I don't think there is any simple solution or fail-safe provision to how one avoids expropriation. Conventional wisdom says that a concession contract or production-sharing agreement should include a stabilization provision that would ensure that the sovereign will maintain the economic equilibrium of the contract or that would allow for certain types of balancing if the government enacts policies that adversely affect the economics of the deal. I think these provisions are great, but they have some practical limitations. One, no government is going to agree to be bound by the provisions of a contract with a private entity that would restrict that government's ability to govern, such as the power to raise taxes on oil and gas companies. Two, there is the problem with the enforceability of the stabilization provision against a sovereign government in the courts of that country, even with an award from an arbitration tribunal. Another common strategy is to take advantage of bilateral and multilateral investment treaties, but once again, it all comes down to enforceability.

Editor: How can parties to a contract best protect themselves in countries in which the rule of law is weak?

Schwind: That is always a challenge. It's hard to put in place a contractual provision that adequately manages problems with the rule of law and respect for property rights. If the contract is governed by the laws of a country or ends up in the courts of a country where the rule of law is an issue, there can be a serious issue of transparency and even concerns about corruption. Sometimes, that risk can be mitigated through political risk insurance policies, but those aren't perfect either. At the end of the day, the company may simply need to decide whether the potential benefits of investing in a particular country outweigh the risks.

Editor: What is the best way for a company that is subject to the FCPA or UK Bribery Act to protect itself from the actions of a joint venture partner or a third-party agent?

Schwind: Our international clients deal with this issue frequently, typically in parts of the world where bribery is simply part of the business culture. Almost without exception, our oil and gas industry clients have drafted an FCPA compliance plan and assiduously enforce it, but it is still very difficult for a company to control an employee, an agent or a local partner who simply goes rogue and decides to make a grease payment. Nonetheless, a company can defend itself by putting in place a solid FCPA policy and by educating and continuously re-educating its employees, contractors and third-party agents about the terms of that policy. Interestingly, some local partners and third-party agents have recognized that they could find themselves at a competitive advantage if they proactively put in place their own FCPA compliance policies. When talking to international oil and gas companies, these entities use their FCPA policies as a selling point that sets them apart from their competitors.

Editor: Please mention some of the transactions in which you have been involved.

Schwind: Over the last couple of years, I've worked with a number of international companies that had been very active in the U.S. shale plays. We have enjoyed helping them not only with the deals themselves, but also to learn how to do business in the United States. I have also worked on several transactions to help companies in Brazil build the drill ships, platforms, drilling rigs, FPSOs and other infrastructure assets that Petrobras will need to develop the country's huge oil and gas resources from the ultra-deepwater pre-salt areas.

Another area of critical interest and activity is Mexico. While the country has abundant oil and gas resources, Pemex has not had the financial wherewithal or the technology to fully develop these resources. This is primarily because the Mexican government has taken so much of Pemex's revenue (in the form of taxes to fund government programs) that the company can't invest in exploration and development. While Mexico has substantial resources in the ground, the country's reserves are now declining due to this lack of investment.

The obvious solution would appear to be to allow private investment in Mexico's oil and gas sector, but the Mexican constitution does not allow private companies to own production or book reserves. Although Pemex has put in place a regime for multiple service contracts that the company is bidding out to private investors, the results have been mixed, and the major international exploration and production companies have not been participating in a meaningful way so far.

As always, the oil and gas industry is unpredictable, and it will be fascinating to see what happens next!