

# DO AREA OF MUTUAL INTEREST AGREEMENTS BREACH THE DOCTRINE OF FREEDOM OF TRADE?

**\*Obinna Dike**



**ABSTRACT:** *Area of Mutual interest agreement is often seen in the oil and gas industry between companies interested in joint or group participating in oil and gas activities within a designated acreage considered by the co-venturers to be of common interest. The paper considers the nature and characteristics of an AMI agreement with a view to examining the reasons why companies' sometimes enter into this kind of agreement while seeking or in preparation for applying for block licence. The paper will also examine the terms of an AMI agreement, rights and obligations of the co-venturers or the contracting companies. The paper will also consider the doctrine of freedom of trade and the extent to which an AMI agreement either promotes or limits the right of the co-venturers to freedom of trade. The paper will conclude by attempting to answer the question whether AMI agreements breach the doctrine of freedom of trade.*

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\* The author is an LL.M student in Petroleum Law and Policy at the CEPMLP, University of Dundee, (UK). He holds an LL.B (Hon) Degree in Law from Nnamdi Azikiwe University, Akwa, Nigeria and BL. from the Nigerian Law School. He worked at the CEPMLP as the Nuffield Research Assistant. He is a member of Association of International Petroleum Negotiators (AIPN), and Energy Institution, (EI) London Chapter. Also he worked at Olisa Agbakoba & Associates, Lagos, Nigeria. E-Mail: [dykechris@yahoo.com](mailto:dykechris@yahoo.com)

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## **ABBREVIATIONS**

AMI agreement      Area of Mutual Interest Agreement

JBA                    Joint Bidding Agreement

## 1.0 INTRODUCTION

Area of Mutual Interest (AMI) agreements are common in the Oil and Gas industry particularly when companies in the industry desire to co-operate or collaborate in pursuit of their business objectives within an acreage. In other words, an AMI agreement provides the legal instrument by which companies in the oil and gas industry agree to carry out certain operations or undertakings jointly as a group within an area designated as mutual interest area. And upon making an AMI agreement, the co-venturing companies come under certain covenants inter se. This will usually include a covenant to the effect that in respect of the area defined as area of mutual interest, all activities must be in conjunction with, or at least in consultation with the co-venturers.<sup>1</sup> Also, none of the co-venturers, party to the AMI agreement will act or pursue any interest in the area either alone or in association with persons who are not parties to the AMI agreement. This is otherwise called *non-compete* provision. In that sense, AMI agreements contain negative covenants and are restrictive in intent.<sup>2</sup>

In the light of the restrictions to which parties to AMI agreements may be subject, the paper considers whether AMI agreements violate the doctrine of freedom of trade. In other words, the aim of the paper is to examine whether AMI agreements are in restraint of trade. To achieve the aim of the paper, the author will, in the context of the oil and gas industry, consider the nature of covenants which AMI agreements usually contain. Also, the common law doctrine of restraint of trade will be examined within the purview of AMI agreements so as to determine whether AMI agreements breach the doctrine of freedom of parties to trade as recognised under the common law.

### 1.1 AMI Agreements: Scope

The essence of an AMI agreement is to identify and record the ambit of the area being agreed to be of mutual interest to the participating companies to the agreement. The AMI agreement will also encapsulate the rules which have been agreed to apply to the defined area.<sup>3</sup>

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<sup>1</sup> Jennings, A., Oil and Gas Exploration Contracts, (London, United Kingdom: Sweet & Maxwell, 2002). P.42

<sup>2</sup> Ibid, p. 43

<sup>3</sup> Mildwaters, K.C., Joint Operating Agreements: A Consideration of Legal Aspects Relevant to Joint Operating Agreement Used in Great Britain and Australia by Participants thereto to Regulate the Joint

An AMI agreement is not intended to deal or does not necessarily relate to any acreage offered by the government under any licensing round. Thus it is not necessary for an AMI agreement to contain specific procedures for putting forward any application for licences. But nothing precludes parties to an AMI agreement from including in the agreement, specific procedure for making any application within the area of mutual interest should they decide to bid for an interest in future.<sup>4</sup>

### **1.2. Joint Bidding Agreements**

It is important to note that AMI agreements are distinguishable from Joint Bidding Agreements. A joint bidding agreement is entered into for the purpose of a joint bid for petroleum title. Where parties to a joint bidding agreement have a prior AMI agreement, the latter agreement may be supplementary to the former. In other words, operations within area of mutual interest would include jointly bidding for petroleum title, and the farming –in to any existing title, within area of mutual interest.<sup>5</sup>

Thus, in its strict sense, an AMI agreement will not contain far reaching provisions like detailed programme of operations<sup>6</sup>. Such details are left for subsequent agreements as they are considered inappropriate for AMI agreements.<sup>7</sup>

### **1.3 AMI agreements and the Oil and Gas Industry: Issues Arising**

An AMI agreement may be approached by the parties as a framework agreement in the sense of simply declaring the parties' intent to conduct oil and gas activities as a group over a defined area. Conversely, parties to an AMI agreement are also at liberty not to choose the piecemeal approach by drafting the agreement in such a way that the agreement is forward-looking. That is, by opting for a very detailed AMI agreement which, in addition to declaring its basic goal, goes further to stipulate terms upon which parties may prospect for, explore or exploit oil and gas resources within the area of mutual interest if they successfully apply for a block or blocks in any licensing round.

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Undertaking of Exploration for Petroleum in Offshore Areas, with Particular Reference to Rights and Duties, Vol.3 (Dundee: University of Dundee(electronic version), 1990).

<sup>4</sup> See Jennings, A., supra note 1 at 43

<sup>5</sup> See Mildwaters, K.C., supra note 3 at 74

<sup>6</sup> In this case, the AMI agreement will usually provide that in all other matters, such as seismic and other studies including application for licences within the area of mutual interest will be carried out jointly.

<sup>7</sup> See Jennings, A., supra note 1 at 43

Regardless of the option adopted in the AMI agreement, the terms of such agreement is very important in order to answer the question whether AMI agreements, broadly speaking, breach the rule against restraint of trade.

In broad terms, AMI agreements will cover the following issues:

- ❖ Define the area in which the parties have mutual interest,
- ❖ Importantly, that the parties will conduct all activities within the area only as a group
- ❖ What happens where a party to an AMI agreement does not want to participate in a particular block within the area covered by the AMI agreement,
- ❖ That the parties will not conduct any such activities with a person or persons outside the group, and
- ❖ That should the parties decide to make any application to the government over any interest within the area of mutual interest, such application or applications will be made jointly.<sup>8</sup>

The terms relevant in order to answer the central question of this paper is the nature and extent of the restriction or restrictions embodied in an AMI agreement, the duration of the AMI agreement and/or the duration of the restriction or restrictions which the particular AMI agreement impose on the parties thereto. These issues will however depend on the nature, purpose or the extent of the co-operation contemplated by the parties to the AMI agreement. These will be treated in fuller details in the next section.

## **2.0 THE DOCTRINE OF FREEDOM OF TRADE**

### *Objective*

The doctrine of freedom of trade is hinged on public policy. It is based on the principle that public interest is best served where parties to commercial transactions have the liberty to enter into legal relations without restrictions as to with whom, where and when such legal relations may be made. The law therefore tries to discourage any restrictions on the right or freedom of an individual to contract except where legal justification exists or where it is in public interest to impose such a restriction or restrictions.

### *Case Law*

The rationale behind the doctrine of freedom of trade was appropriately captured by the time tested dictum of Lord Macnaghten<sup>9</sup> when he stated that:

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<sup>8</sup> Ibid, at 43

<sup>9</sup> Nordenfelt v. Maxim Nordenfelt Guns & Ammunition Co. Ltd [1894] A.C. 535 at 565

*“...The public have an interest in every person’s carrying on his trade freely: so has the individual. All interferences with individual liberty of action in trading, and all restraint of trade of themselves, if there is nothing more, are contrary to public policy and therefore void... (Italics mine)”*

Following this principle, contracts which impose or purports to impose restraints on the freedom or liberty of individuals to contract are strictly construed by courts particularly in common law jurisdictions. This point will be further developed in the context of AMI agreements in the next section.

## **2.1 Oil and Gas Agreements and Freedom of Trade**

In the oil and gas industry, many contracts are negotiated between individuals or companies that may impose restraints on the parties. These contracts may or may not be in breach of the freedom of trade. In other words, they may or may not be in restraint of trade. In this paper, few of these oil and gas agreements will be briefly discussed for illustration purposes.

### *AMI Agreements*

AMI agreements, as has been discussed earlier, are used in the oil and gas industry by participants in the industry who consider themselves to have mutual interest in a particular area called the area of mutual interest as well as capacity to complement each other for the advancement of their individual business interests.

The business interests which may be envisaged in AMI agreements may include sharing of business risks inherent in the industry, spreading the cost of business operations, pooling of their respective knowledge, data and information with respect to a block or in anticipation of any bidding rounds.<sup>10</sup> It may also be to protect a party, or some of the parties against competition amongst or between members of the group covered by the AMI agreement.

Following the above objectives, AMI agreement usually contain covenants which restrain the parties from pursuing any interest within the area delineated as the area of Mutual Interest as an individual or in conjunction with persons outside the group over a period of time. Some of the covenants will include the following:

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<sup>10</sup> See Mildwaters, K.C., supra note3 at 72-73

### *Data Exchange*

One of the initial obligations of the co-venturers may include the duty to share all seismic and other relevant data in their possession. This duty may be backed by a confidentiality agreement. Information in the possession of a co-venturer which is subject to confidentiality agreement is usually excluded.<sup>11</sup>

### *Group rights*

Modern AMI agreements may permit the co-venturers to bring their respective co-venturers under other agreement for the purpose of all or particular licensing rounds.

This provision is said to be in contemplation of future joint ventures with parties other than the co-venturers.<sup>12</sup>

### *Failure to Agree*

The agreement may permit right of withdrawal from an application, subject to that co-venturer complying with any stated pre-conditions

### *Duration of the AMI agreement*

Noting that AMI agreements may not be for the purpose of a particular application, the agreement may last for a long period. However, it is said that it is becoming increasingly hard to bind any group of companies for any long period unless the agreement provides for an easy termination procedure.<sup>13</sup>

### *Joint Bidding Agreement (JBA)*

As mention above, joint bidding agreement may form part of a detailed AMI agreement or constitutes an independent agreement. JBAs are used by parties to which it relates to make joint application for block or blocks in any bidding round. It usually contains a clause or covenant forbidding the co-venturers from bidding for block or blocks other than as a group.

### *Confidentiality Agreement*

In the industry, confidentiality agreements are used to protect information or data which a party to an AMI agreement, a JBA or any other agreement, may have become privy to by

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<sup>11</sup> Ibid, at 45

<sup>12</sup> Ibid

<sup>13</sup> Ibid, at 46



virtue of being part any of these agreements. It bars a co-venturer from using the said information or data for a purpose other than that for which it was acquired. This restraint or prohibition sometimes remains binding years after the life of the agreement.<sup>14</sup>

In any of these instances, the restraints imposed may be in restraint of trade and thus may or may not be void, depending on the circumstances of each case. The principles of the common law doctrine of restraint of trade will next be considered.

### **3.0 AREA OF MUTUAL INTEREST AGREEMENT AND RESTRAINT OF TRADE**

#### **3.1 The Doctrine of Restraint of Trade: Definition**

According to Lord Diplock<sup>15</sup> a contract is in restraint of trade where a party (the covenantor) agrees with another (the covenantee) to restrict or limit his or her liberty in future to carry on trade with other parties not being parties to the contract in such a manner as he chooses.

#### **3.2 Development**

The doctrine of restraint of trade is a rule of public policy developed by the common law.<sup>16</sup> As developed in the early times by English common law, all agreements in Restraint of trade were considered unenforceable, against the interest of parties and contrary to public policy and thus unenforceable.<sup>17</sup>

But as time went on the absolute ban began to experience gradual modification. The reason for this modification of the doctrine was, in the words of Lord Ashbourne<sup>18</sup>, due to “...*the exigencies of an advancing civilization...*” as well as its rigidity.

So, in Mitchel’s case<sup>19</sup>, the English House of Lord had another opportunity to consider the rule against restraint of trade. A distinction was then made between Partial or particular and general restraint of trade. Partial restraint was accepted as reasonable while general restraint was considered unenforceable for all purpose. The principle relating to partial and general restraint will then be discussed.

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<sup>14</sup> David, Martyn, R., Upstream oil and gas agreements with precedents,( London, United Kingdom: Sweet & Maxwell,1996). P. 73

<sup>15</sup> See Petrofina ( Great Britain) Ltd v. Martin [1966] Ch. 146, at 180

<sup>16</sup> Bellamy, J., *Restraint of Trade: General Principles & Recent Developments* (Unpublished paper, 27 July 2004)

<sup>17</sup> See the Nordenfelt case, supra note 9 at 556

<sup>18</sup> Ibid at 556

<sup>19</sup> Mitchel v. Reynolds 1 P. Wms. 181

### **3.3. General Restraint**

Contracts in general restraint of trade are those by which a person, natural or corporate, restrains himself or itself from all exercise of his or its trade in any part of a country or the world.<sup>20</sup> Traditionally, this kind of restraint is void and the court will not inquire into the reasonableness or otherwise of the transaction. In other words, the policy of the law at that time was against general restraint.

### **3.4 Partial or Particular Restraint**

Conversely, partial restraints are restraints which limit a person's right to exercise his trade to a region or to section of a country. This type of restraint was generally considered to be enforceable especially where the covenantor received consideration which the court considered to be adequate.<sup>21</sup>

### **3.5. Current Position**

The law now de-emphasises spatial differences differentiates. The enforceability or otherwise of a contract in restraint of trade is now subject to one test: reasonableness. This test is now known as the Nordenfelt test. The dictum of Lord Macnagten which was quoted earlier will now be reproduced in full:

*"...The true view at the present I think is this: The public have an interest in every person's carrying on his trade freely: so has the individual. All interference with individual liberty of action in trading, and all restraints of trade themselves, **if there is nothing more,** are contrary to public policy, and therefore void. That is the general rule. But there are exceptions: restraints of trade justified by the special circumstances of a particular case. **It is a sufficient justification, and indeed it is the only justification, if the restriction is reasonable-** reasonable, that is, in reference to the interests of the parties concerned and reasonable in reference to the interest of the public, so framed and so guarded **as to afford adequate protection of the party in whose favour it is imposed,** while at the same time it is no way injurious to the public. That, I think, is the fair result of all the authorities..."<sup>22</sup> (Emphasis mine)*

In these words, the House Lord unanimously established the operative doctrine of restraint of trade. Thus, it is no longer sufficient to consider just the spatial coverage of the restraint, the facts and circumstances of each case must be carefully examined to determine whether a covenant or contract is against the rule on freedom of trade and consequently void or

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<sup>20</sup> See the Nordenfelt case, supra note 9 at 561

<sup>21</sup> Ibid

<sup>22</sup> Ibid, at 565

unenforceable. The next issue to be considered is the test to be applied in each particular case in order to arrive at whether a breach of the doctrine has been occasioned.

### **3.6. Reasonableness**

In order to determine whether a restraint in a given case is reasonable, the question may be posed: when can a restraint on a party's right to trade be a breach of the freedom of trade?

It suffices to say that all contracts in which a form of restraint has been imposed involves a derogation but not all contracts involving such a derogation are contracts in restraint of trade. Where a man undertakes to do something or to conduct himself in a particular manner, he thereby puts it wholly or partly out of his ability to engage in any trade or business he chooses during the period.<sup>23</sup>

Thus, an AMI agreement must be appraised as a whole to first determine if there is a restraint, where one exists, a further consideration will be given to the extent of the restraint and this will lead one to the conclusion as to whether the agreement in question is in breach of the freedom of trade.<sup>24</sup> In other words, one must take a critical look at the restrictive clause in its context.

#### *Examples*

In *Young v. Timmins*<sup>25</sup> a servant had undertaken that he will not work for anyone else but was not given any job and received no remuneration from the covenantee for a reasonable period of time. He was deprived of a livelihood. The restraint was held to be unreasonable in the circumstance and therefore void.

In *Esso*,<sup>26</sup> two separate contracts came before the court for interpretation. The Appellant was an oil company which has as part of its business the production and marketing of petroleum products, the relevant product in this case being Esso Petrol. The Respondents owned two garages; it contracted with the Appellant under a "solus agreement" and bound itself to sell only the product of the Appellant for a period of 5 years and 21 years respectively. The 21 year contract was coupled with a mortgage of one of its garages which was to be irredeemable before the expiry of the 21 year period.

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<sup>23</sup> *Esso Petroleum Co. Ltd. V. Harper's Garage (Stourport) Ltd.* [1968] AC 269 at 294

<sup>24</sup> *Ibid*, at 291

<sup>25</sup> See *Young v. Timmins* [1831] 1 Cr. & J. 331

<sup>26</sup> See *Esso v. Harper's Garage*, *supra* note 19 at 291, 302,314

In a proceeding for the enforceability of the two contracts, it turned to be decided whether the contracts were void and unenforceable for being in breach of the doctrine of restraint of trade. The court, in coming to decision, looked at the nature of the Appellant business, the nature of and business practices of trade, the volume of the Appellants investment and the need to secure a predictable distribution channel and held the restraint in the 5 year contract reasonable. In respect of the 21 year contract, the court found that restraint imposed went beyond what was reasonably necessary to protect the Appellant's genuine business interest.

In *Nordenfelt case*, the restraint was a general one which operated all over the world and for a period of 25 years. However, the court had no difficulty in coming to a decision that the restraint imposed in that case was reasonable and justified based on the facts of the case. It was a case of a sale of the business of the manufacture of arms and ammunition. The court took three important points into account in arriving at its decision; the first was that the nature of the trade was such that the Respondent's clientele was limited (to namely the Governments of the United Kingdom and few other countries). The second point was that the Respondent cannot enjoy the full value of the business purchased unless the Appellant restrained himself in that manner<sup>27</sup>. The third was that the restraint was not injurious to the public interests of the United Kingdom.

### **3.7 Public Policy**

Public policy is a dynamic conception influenced or shaped by the needs of the time, the level of development and other circumstances affecting a state at any time. As these circumstances change, the public policy of a state is most likely to change. This is important to appreciate the way the court have approach the issue of public policy in the cases on restraint of trade. The early common law attitude was that all restraints upon trade are bad for being offensive to public policy<sup>28</sup>. The view of the common law then was that safeguarding the freedom to trade was an overriding interest of the state. But by effluxion of time, the need to balance this interest of the state with other competing interests became apparent. The burden of proving reasonability and public policy will then be considered.

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<sup>27</sup> Ibid, at 574

<sup>28</sup> Ibid, at 546

### **3.8 Burden of Proof**

Where the enforcement of an agreement or a contract is challenged for being in breach of the freedom to trade, the burden of proof is usually shared between the parties to the legal action. The law is settled<sup>29</sup> that the onus is on the party seeking to enforce the restraint to prove that the restraint is reasonable in the circumstance of the case. In doing this, that party must adduce credible evidence to show that the restraint imposed is not beyond what is necessary for the protection of his legitimate interest.<sup>30</sup> It should however be noted that a covenant against competition will never be regarded as reasonable.<sup>31</sup> This is because no individual has any legal right to be protected from competition<sup>32</sup>.

On the other hand, the onus of establishing that the restraint imposed by the covenant is contrary to public policy is upon the party challenging the restraint on that ground, this is usually the respondent or defendant. Again, it is important to add that a person may impugn a covenant as being in breach of the freedom of trade only where the alleged restrictive covenant seeks to take away a right which that person already had before the agreement. So, a person who purchases a property, for instance, which carried some restrictions to its use, cannot afterwards repudiate the agreement on grounds of the alleged restrictions.<sup>33</sup>

The manner in which the courts, through the cases, try to balance the various interests against restrictive covenants will now be considered.

### **3.9 Balance of Interests**

In examining the way in which the courts have attempted to maintain a balance when faced with covenant in restraint of trade, the author will start with the words of Lord Shaw in<sup>34</sup> when he said:

*“ ...In these cases, as I have pointed out, there are two freedoms to be considered- one the freedom of trade and the other the freedom of contract: and to that I will now again venture to add that **it is a mistake to think that public interest is only concerned with one; it is concerned with both...**” (emphasis mine)*

So, whenever it is alleged that a contractual relationship (which is not prima facie illegal) is in restraint of trade, it is crucial to also realise that there is another equally important freedom

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<sup>29</sup> See *Esso v. Harper's Garage*, supra note 19 at 319

<sup>30</sup> See *Nordenfelt v. Maxim Nordenfelt*, supra note 9, at 569

<sup>31</sup> See *Esso v. Harper's Garage*, supra note 19, at 319

<sup>32</sup> *Ibid*, at 288

<sup>33</sup> *Ibid*, at 298

<sup>34</sup> See *Herbert Morris Ltd. v. Saxelby* [1916] 1 AC 688, 716

which ought to attract the protection of public policy-the freedom of commercial men and women to enter into contracts binding in law and equity.

This is important because where business contracts are made by parties who are on equal terms, and if there is no irregularity, it is not the business of the law to alter agreements merely for the relief of those for whom events have turned out badly.<sup>35</sup>

It should thus be paramount to public policy that agreements validly made are not lightly interfered with by the courts.<sup>36</sup>

### **3.10 Application**

Considering that no judicial authority has yet determined the applicability of the doctrine of restraint of trade to AMI agreements, the question may be asked whether the doctrine applied to oil and gas industry agreements generally and AMI agreements in particular. It would seem that the general rule remains that covenants in restraint of trade are prima facie void. This general rule should apply to the oil and gas industry contracts and specifically speaking, to AMI agreements.<sup>37</sup> Thus, without anything more, AMI agreements which breach the doctrine of freedom of trade will be adjudged unenforceable if challenged in court.

From the above analysis on AMI agreements, it is safe to say that AMI agreements normally will contain clauses which restrain the co-venturers from pursuing individual interest or in conjunction persons outside the group within the area of mutual interest. A covenant which contains any of the above restraints may be void. The covenant may also be adjudged reasonable if it is not wider than that required for the protection of the party or parties in whose favour the restraint is made.

As noted earlier, AMI agreements cannot validly be used to protect a party or the co-venturers from competition. That will be against competition law and the law does not permit that. No person has a right to be protected against competition.

Upon this premise, confidential agreements, whether contained in AMI agreements or not, may breach the doctrine against freedom of trade. However, the devil they say is in the details. So, the nature and duration of restrictive clause(s) need to be critically construed to determine if the clauses are unreasonably in restraint of trade and therefore in breach of the freedom of trade. It is the facts and circumstances of a particular case that must be examined.

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<sup>35</sup> See *Esso v. Harper's Garage*, supra note 19, 305

<sup>36</sup> See *Nordenfelt v. Maxim Nordenfelt Guns*, supra note 9 at 552

<sup>37</sup> Evans, A., *The Doctrine of Restraint of Trade in Relation to Music Agreements*, (Buckinghamshire, United Kingdom: Buckinghamshire Chilterns University, May 2006).

The nature of the oil and gas industry is also very important.<sup>38</sup> In doing this, it is crucial to bear in mind what is reasonably required for effective interpretation of the intentions of the makers of the agreement.<sup>39</sup> For instance factors like strong technical capability of a party, technical knowledge of the group's chosen geographical area of interest/previous success in acquiring licence acreage in the vicinity of a party, financial capacity, commercial abilities, flexibility, and political capability of party may have been very pivotal in reaching the agreement. So, a claim to breach of freedom of trade must be balanced against these factors. The doctrine of restraint of trade has been held applicable to commercial contracts like mortgages.<sup>40</sup> It also applies to the music industry<sup>41</sup>, employment, vendor/vendee, partnership, and other commercial agreements<sup>42</sup>

### **Conclusion:**

An attempt has been made to explain the idea or the purpose of AMI agreements, where and how they are used. Also, effort has been made to establish that AMI agreements usually contain covenants in restraint of trade or covenants which prima facie curtail or restrict the freedom of trade.

Additionally, the doctrine of restraint of trade has been defined and analysed. The result being that to the general rule that covenants or contracts in restraint of an individual's right to trade are bad and therefore contrary to public interest. However, there is an exception. Is the agreement reasonable in the circumstances of that particular case? Is the restraint beyond or wider than what is reasonably required to protection the legitimate interest of the covenantee? If these questions can be answered affirmatively, then, the restraint is reasonable, not contrary to public policy and enforcement.

So, there is no straight answer to the question whether AMI agreements breach the doctrine of freedom of trade. The facts and circumstances of each AMI agreement must be considered and the competing interests examined to determine whether the imposed restraint is reasonable or not.

The relevant approach should then be to always identify what the covenantee's legitimate interest within the borders of the AMI agreement is. The next will be to examine the words of

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<sup>38</sup> See *Esso v. Harper's Garage*, supra note 19, at 292,305,312

<sup>39</sup> See *Nordenfelt v. Maxim Nordenfelt Guns*, supra note 9 at 553 & 555

<sup>40</sup> *Ibid*, at 314

<sup>41</sup> See *Evans, A.*, supra note 33

<sup>42</sup> See *Bellamy, J.*, supra note 13, at 6

the restrictive clause as to time or duration of the restriction. From these, conclusions will be drawn as to whether the restraint is reasonable and valid or unreasonable and void. It is no longer relevant that the restraint imposed is general or partial, reasonableness is always the test.



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