JUDGMENT : Mr Justice Moore-Bick: Commercial Court. 2nd February 2004

1. Introduction

1. In August 1995 the semi-submersible oil production platform *Spirit of Columbus* was delivered to her owners, Societa Armamento Navi Appoggio S.p.A. ("SANA"), on completion of her construction by the Italian shipyard Sestri Cantieri Navale S.p.A. However, SANA was unable to employ the vessel and it therefore allowed the third Part 20 defendant, Maritima Petroleo e Engenharia Ltda ("Maritima"), to negotiate a sale to a third party. Maritima is a Brazilian company which has for many years been involved in the management of projects for the construction of drilling rigs and production platforms for use in the offshore petroleum industry. Much of its work has been undertaken for the first defendant, Petroleo Brasileiro S.A. ("Petrobras"), the Brazilian state petroleum company, with which it has had a long and fruitful association. Maritima was founded by Mr. German Efromovich who is currently its managing director.

2. In 1996 Mr. Efromovich knew that Petrobras had been interested for some time in obtaining the *Spirit of Columbus* and adapting it for service in the South Marlim oilfield in the Campos Basin. In about June 1996 Petrobras provided Maritima with a general specification for a production platform suitable for use in the South Marlim field and thereafter Mr. Efromovich began negotiations with SANA, its parent company, Midland & Scottish Resources Plc ("MSR"), the banks and other institutions which had provided finance for the building of the vessel, and with Petrobras itself with a view to putting in place a scheme that would enable the vessel to be upgraded and made available for that employment.

3. The first formal record of the parties' commitment to the project is to be found in a Memorandum of Agreement dated 6th November 1996 made between Maritima and Petrobras. One of the issues for determination in these proceedings is whether that agreement was intended to create binding obligations of any kind, but for present purposes it is sufficient to say that it set out the main terms that were to govern the project while contemplating that detailed agreements would be entered into at a later stage to give effect to its terms.

4. The essential elements of the contractual structure envisaged by the Memorandum of Agreement were these: Maritima, or a wholly-owned subsidiary to be incorporated for the purpose (referred to in the document as *'Leaseco'),* was to acquire the vessel with a view to upgrading it and transferring title to the second defendant, Braspetro Oil Services Co ("Brasoil"), a wholly-owned subsidiary of Petrobras, under a 12 year bareboat charter with a purchase option at the end of the period. Brasoil would in turn make the vessel available for use by Petrobras under a bareboat sub-charter for the same period. In the event a new company, Petro-Deep Inc., was incorporated by Maritima for the purposes of purchasing the vessel from SANA and entering into the relevant contracts with Brasoil. On 10th January 1997 Petro-Deep and Brasoil entered into an agreement described as an *'Agreement in relation to Bareboat charter with Purchase option'* paving the way for the execution of a 12 year bareboat charter with an option to purchase the vessel at the end of the charter period and a contract for the upgrading of the vessel to make her suitable for service in the South Marlim field. The vessel was to be re-named *P-36*.

5. Towards the end of 1996, however, a very large new oilfield, which has since become known as the Roncador field, was discovered in the Campos Basin. Its discovery came at a time when Brazil was liberalising the regime under which petroleum exploration and production licences were granted with a view to ending the existing state monopoly. Petrobras considered it vital to its interests to bring the new field into production before these changes came into effect and by January 1997 a proposal had emerged to put *P-36* into service in Roncador instead of South Marlim. It was approved by the board at the end of February.

6. At that time the Roncador field was still being evaluated and indeed further information about sea conditions and the characteristics of the crude oil contained in the field continued to emerge for some months. It was already becoming apparent, however, that conditions there were quite different in many respects from those in South Marlim and that it would be necessary to make some significant changes to the design of the upgraded platform to render it suitable. As a result this became a most unusual project in which the design was being developed even while the work on the upgrading was in progress. This was a new experience for both parties and was made more difficult by the fact that they were acting under severe pressure of time. From about March 1997 Maritima began working on the design for the Roncador project in place of South Marlim, but the change was not recorded in any formal agreement.

7. The negotiation of agreements that satisfied the requirements of all those involved with the vessel, including not only the banks which had financed its original construction but also the banks that had agreed to finance the purchase and upgrading project, proved to be complicated and time-consuming, so much so, that, having reached agreement in principle on terms to implement the South Marlim project, neither Maritima nor Petrobras wanted to re-open the discussions in order to make the changes that were required to give effect to the Roncador project. That explains why on 20th June 1997 the parties entered into formal agreements designed to give effect to the South Marlim project despite the fact that that project had been superseded months earlier.

8. The existing liabilities relating to the construction of the vessel as well as the purchase and upgrading of *P-36* were all to be financed out of the hire payable by Petrobras under the bareboat sub-charter. In order to obtain sufficient funds to carry out the upgrading work Petromec intended to assign its share of the hire to banks supporting the project as security for loans. Similarly, the banks that had financed the construction of the vessel were to recover their loans out of the hire and they also required security. In order to protect their position the banks insisted that the company to which the hire was payable should be insulated from any potential liability in respect of the upgrading

work. Accordingly, although Petro-Deep formally undertook to procure the upgrade of the vessel, it was agreed that it could fulfil its undertaking simply by entering into contracts for the work, provided they were approved by Brasoil.

9. At an early stage in the project Davie Industries Inc., which operated a shipyard in Quebec, was identified as a suitable contractor to carry out the shipyard element of the upgrading works. Davie enjoyed a reputation for high quality work and it was thought that financial support for the shipyard work could be obtained from the Export Development Corporation of Canada ("EDC"). However, in order to secure the position of Petro-Deep and to enable it to retain the management of the project, Maritima incorporated a second company, Petromec Inc., for the sole purpose of entering into a contract with Petro-Deep for the upgrade of the platform and managing the work. Petromec itself entered into contracts with various contractors and suppliers for equipment and specialist services and a contract with Davie for the necessary shipyard work.

10. Despite the large number of different bodies involved in what was on any view a complicated contractual structure, there were really only two main parties to the project: Maritima and Petromec, on the one hand, and Petrobras and Brasoil on the other. Petromec was the contracting party representing Maritima's interest, but it had no assets of its own and depended entirely on the support it received from Maritima to carry out its functions. Petromec employed a project manager, Mr. Otoniel Reis, and a project team to supervise the upgrade, but all commercial decisions of any consequence were taken by Mr. Efromovich. During the months leading up to the final closing in June 1997 Mr. John Hawksley, the managing director of MSR, was heavily involved in the negotiations on behalf of his own company. He subsequently oversaw the closure of MSR's business and eventually became a consultant to Maritima in about March 1998, although he had been providing advice and support to Mr. Efromovich in connection with the *P-36* project for some months before that.

11. The relationship between Brasoil and Petrobras was also very close. It is not clear from the evidence whether Brasoil maintains any staff of its own, but in this case it engaged Petrobras to provide all the management services necessary to perform its obligations in relation to the project and as a result the general supervision and day to day management of the upgrade was carried out by members of Petrobras's Engineering department. It will be necessary to mention in due course the part played by several of its employees, but the two who were most closely involved throughout the life of the project were Mr. Antonio Justi and Mr. Henidio Jorge. As might be expected, the funds needed to carry out the project were provided entirely by Petrobras which took all the effective decisions in that respect also. One consequence of these arrangements was that although Brasoil was a party, and in some cases the only party, to most of the agreements with Petromec and Petro-Deep, all communications were conducted with employees or representatives of Petrobras and all decisions affecting the project were taken by Petrobras both on its own behalf and on behalf of Brasoil. In these circumstances, whatever Petrobras said or did was intended to affect its own position and that of Brasoil and accordingly, except where it is necessary to distinguish between them, I shall refer in this judgment simply to 'Petrobras' as a convenient way of referring to both companies.

12. Even as they were signing the contractual documents giving effect to the South Marlim project Petromec and Petrobras were aware that at some point it would be necessary to enter into further agreements to reflect the change to the Roncador project. It is perhaps surprising that Mr. Efromovich was willing to begin work on the new project without any kind of formal record of the terms on which it was to be carried out, but the fact that he was is a reflection of the high degree of trust and co-operation that had been built up between the Maritima group and Petrobras over many years. Mr. Efromovich was assured by Petrobras that it would bear the whole of the costs resulting from the change to Roncador and he was prepared to begin work on the faith of that assurance. After the South Marlim documents had been signed in June 1997, however, both sides began to give some thought to the need to make formal provision for the changes in the contractual documentation required by the new project. It was also necessary to ensure that Petrobras had the right to supervise the work. Over the course of the next few months, therefore, there emerged a draft of a Supervision Agreement to be entered into by Petro-Deep, Petromec, Brasoil and Petrobras which, as its name implies, was designed in part to give Brasoil certain rights to supervise the upgrading of *P-36*. Another of its functions, however, was to provide for the change from the South Marlim project to the Roncador project. The Supervision Agreement was dated as of 20th June 1997 (i.e. the same date as the South Marlim agreements) but in fact it was not executed until August 1998.

13. The platform arrived in Quebec on 29th August 1997 and work on the upgrade began on 26th September. The project was in financial difficulties almost from the start because it proved difficult to persuade EDC to lend the necessary funds, but in December 1997 Chase Manhattan Bank agreed to make a loan of US$45 million that enabled the work to keep going. However, funds remained tight and in March and April 1998 Petromec submitted the first of a series of sets of variation orders to Petrobras in an attempt to recover some of the cost that had arisen from the change of project.

14. The discussions that followed have given rise to a significant dispute between the parties. It will be necessary to return to them in detail at a later stage, but for the time being it is sufficient just to mention the salient features. The variation orders identified specific changes to the original specification and put forward claims for the cost likely to be incurred in carrying them out. However, Mr. Efromovich and Mr. Reis made no secret of the fact that Petromec had made no attempt to produce detailed costings but had simply put forward a figure which it regarded as a reasonable amount for the completion of the additional work. Having costed the work for themselves, the Petrobras engineers considered that only about half the sum claimed by Petromec could be justified. Discussions then took place between the parties in the course of which, according to Mr. Efromovich, he was assured that Petromec could re-open the variation orders if it could show that the costs had in fact been greater than Petrobras was then willing to accept.

15. In the event Petrobras, Petromec and Petro-Deep signed a letter dated 9th July 1998 in which the amount due in respect of the variations was expressed to be agreed at a little under US$43 million. Petromec's case is that it was induced to sign the letter by the threat that nothing would be paid if it did not do so and by an assurance that it would not be prevented from recovering further amounts for the work in question, if they could be justified. Further sets of variation orders were submitted to Brasoil in November 1998 and at various times thereafter.

16. Throughout the following months the financial position remained difficult, partly because Davie's own finances were shaky and partly because Petromec was finding it hard to obtain the funds it needed to keep the project going. In December 1998 EDC finally offered to provide finance, but it seemed likely that it would take some time to complete the formal documentation and the project had to be kept running in the meantime. Petromec approached Petrobras for a bridging loan of US$40 million. In the end Petrobras agreed as a first step to make available US$1.5 million a week up to a total of US$15 million in order to ensure that the workforce at the yard was not laid off. A running battle broke out at about that time between Petromec and Petrobras over whether those payments were to be treated as loans or as further payments on account in respect of the additional costs of the Roncador project.

17. A new board of Petrobras was appointed towards the end of April 1999 following elections in Brazil. This proved to have unforeseen repercussions to which I shall come in due course.

18. In May 1999 a suggestion was made that Petrobras might make funds available to Petromec by making payments direct to sub-contractors and suppliers. These payments would stand as loans that could be set off against amounts due to Petromec in respect of the additional costs of the Roncador project. In order to give effect to this suggestion the parties executed a formal document entitled 'Deed of Payment and Indemnity' ("DPI"). One of the recitals to that deed confirmed that certain variation orders that were attached as an appendix were not subject to any further claims. The circumstances in which the deed came to be executed by Mr. Efromovich on behalf of Petromec are in dispute. Petromec's case is that he was induced to take that step by an assurance from Mr. Rui Dias, then head of Petrobras's legal department, that the document would not be held against Petromec. However, Petrobras denied that Mr. Dias had said anything of the kind.

19. While the negotiations for the provision of funds in this manner were going on Petromec was also pursuing its negotiations with EDC and Chase Manhattan. EDC was not willing to make a loan to Petromec unless it received a guarantee from Petrobras of Petromec's obligation to repay it. There were legal impediments to its doing that, but as an alternative Petrobras was willing to provide formal confirmation to Petromec of its obligation to pay hire under the bareboat sub-charter which Petromec could assign to EDC by way of security. In order to implement that arrangement Petromec and Petrobras executed a document entitled 'Deed of Confirmation and Indemnity' ("DCI"). One clause of that document contained an undertaking by Petrobras to indemnify Petromec against all losses incurred by it in respect of the "upgrade". One of the issues between the parties is whether by executing this deed Petrobras incurred an independent obligation to Petromec to indemnify it against all the additional costs incurred in carrying out the Roncador project.

20. By the summer of 1999 both sides seem to have become a little weary of producing and analysing variation orders and arguing over whether Petromec was entitled to additional payments in respect of work that had been covered by earlier variation orders. A suggestion was made that they should adopt instead what became known as a 'global settlement approach' under which Petrobras would audit Petromec's books to ensure that the costs of the work were not being inflated and the parties would seek to agree on the costs of completing the original South Marlim project. Petrobras would pay Petromec the difference (after allowing for what had been paid already) and perhaps also (if Mr. Efromovich could persuade it to do so) a mark-up to provide an element of profit on the additional costs.

21. The global settlement approach was attractive to both sides. It was discussed and agreed at a meeting between Mr. Efromovich and Mr. Menezes, a newly appointed director responsible for the engineering department, over breakfast during the course of a visit to Quebec in June 1999 and there were subsequently meetings between Mr. Efromovich and another member of the engineering department, Mr. Nelson, at which the cost of the South Marlim project was discussed. A team of accountants from Petrobras examined Petromec's books during the first half of August and at a meeting in September Mr. Efromovich and Mr. Nelson reached agreement on a figure of US$112 million for the South Marlim costs. Mr. Efromovich asked for a 10% uplift to cover administration and a measure of profit. It is common ground that Mr. Nelson did not agree to that, though Mr. Efromovich said he gained the clear impression that Mr. Nelson thought that would be fair. At that point Mr. Efromovich thought that payment was assured and it is part of Petromec's case that as a result of the agreements Mr. Efromovich had reached with Mr. Menezes and Mr. Nelson Petrobras did become bound to pay the difference between the total costs of the project less the amount of US$112 million attributable to South Marlim.

22. However, Mr. Efromovich's optimism proved unjustified. Although a proposal for payment on that basis (including a 10% uplift) was placed before the board of Petrobras at a meeting on 7th October, it was shelved and was never approved. Meanwhile, the work was well advanced and the approach of winter made it highly desirable from Petrobras's point of view that the vessel should leave the St. Lawrence before it became frozen in. Arrangements had already been made for it to be dry towed to Brazil for completion, leaving the St. Lawrence during October. As the time for its departure approached Petromec began to express concern about payment of the additional costs, but letters were written by Mr. Jorge and Mr. Justi on 11th and 25th October saying that the matter was still being considered by the board. In the event Petromec did not take any steps to prevent the vessel's departure and she was formally released to Petrobras on 28th October.

2. The proceedings

23. In this action Petromec is seeking to recover the balance of the amount which it says is due in respect of the additional costs generated by the Roncador project. Brasoil and Petrobras have made a claim for damages for delay in the completion of the upgrade. On 29th October 2002 an order was made by consent that a number of preliminary issues be tried in order to determine the true state of the contractual relations between the parties before they embarked on a potentially costly exercise to determine their claims for increased costs or delay, as the case may be.

24. The preliminary issues are formulated in very detailed terms and I do not propose to repeat them here. It is convenient to consider them in groups and the events to which they relate in chronological order. Since the parties' relationship was continuously developing, there is a greater likelihood of arriving at a true understanding of the position if each stage in that development is considered in the light of the events which preceded it.

3. The Memorandum of Agreement ("MOA")

25. By the time the MOA was signed on 6th November 1996 considerable progress had been made in establishing the engineering and technical content of the project for the acquisition and upgrading of the platform. Petrobras had provided Maritima with a basic engineering design in June 1996 (although it still required further development) and the basic structure of the contractual arrangements was taking shape. Negotiations were under way with Davie and with EDC, but since the plan was to finance both the purchase and the upgrade out of hire payable under a charter to Petrobras, it was difficult to make progress in talks with financial institutions until Petrobras and Maritima had committed themselves in principle to the project and potential lenders were satisfied that it would be structured in a way that met their basic requirements. It is right to point out that none of the parties to the project, including SANA and MSR, had yet given their unconditional agreement to the proposals and that no one expected them to do so until a formal closing took place at which documents embodying the transaction as a whole would be signed. There was still a lot to be negotiated and agreed before the project could finally be established.

26. The first question for consideration is whether the MOA was intended to give rise to legally binding obligations of any kind, or whether it was merely intended to contain a statement of intent. Ms Prevezer Q.C. submitted that the latter was the case. She referred me to an early draft of the document which stated that its objective was to regulate the initial steps towards setting up a financial structure for the project and to later drafts which contemplated that the parties to the agreement would be Petrobras and a special purpose vehicle identified as "Leaseco". She also drew my attention to various documents dating from December 1996 onwards in which Petrobras and its advisers had expressed themselves in ways which suggested that they did not consider the MOA to have any long-term relevance to the parties' relationship.

27. In my view none of this material is of much assistance in deciding what the parties intended to achieve by entering into the MOA. It has long been established that prior negotiations, in which must be included exchanges of drafts, are not admissible as an aid to the construction of a written agreement: see ***Prenn v Simmonds*** [1971] 1 W.L.R. 1381. The same must, I think, be true when the question is whether the document signed by the parties was intended to be legally binding. It is important, of course, to have regard to the surrounding circumstances which may shed valuable light on the matter, but I do not think that any help is to be gained from the parties' negotiations as such for the reasons expressed by Lord Wilberforce in ***Prenn v Simmonds*** at page 1384G. Nor do I think that any help is to be gained from subsequent expressions of opinion on one side or the other about the effect of the document. The position may be different, of course, if it can be seen that the parties have conducted their affairs on a common understanding of the document's effect, but that is not said to be the case here. In these circumstances I think that the question is to be answered simply by reference to the terms of the document itself and the circumstances in which it came into existence.

28. I start with the MOA itself. The first thing one notices about it is its formal style. It was laid out in the manner of a legal document and the choice of language suggests that the parties were seeking to achieve something beyond the mere recital of good intentions. That in itself may be only a slight indication, but it is powerfully reinforced by the opening declaration that *" . . . . in consideration of the mutual covenants contained herein the parties hereto agree as follows: . . . "*

29. The MOA began with a number of recitals which were intended to provide the context for the substantive provisions that followed. These recorded that Petrobras had decided to install a production platform; that the *Spirit of Columbus* would be suitable for its purposes, if it were upgraded in an appropriate manner; that Brasoil intended to acquire the vessel, provided it was free of encumbrances and had been upgraded in accordance with Petrobras's requirements; and that Maritima warranted that it would acquire the right to transfer the vessel to Brasoil free of encumbrances and would upgrade it in accordance with Petrobras's requirements.

30. The substantive terms of the MOA dealt with various aspects of the project. The following are of most interest for present purposes:

"1. PARTICIPATION AGREEMENT

PETROBRAS, BRASOIL, MARITIMA, LEASECO, SANA, ABC, FINCANTIERI and MSR, if necessary, and any other Persons, whether Public or Private, whose authorisation, approval or other consent is or might be required for the valid and legal accomplishment of the transaction contained herein, will enter into an Agreement (hereinafter referred to as PARTICIPATION AGREEMENT) with a TRUSTEE, to be nominated under mutual agreement among the related parties, ...

The TRUSTEE's responsibilities shall, without being limited to, include the following: . . . . .

Any mortgage, security, credit, interest or other LIEN holder, will also undertake that they will timely give the above mentioned quittances . . . . . .

2. MARITIMA'S UNDERTAKINGS AND COVENANTS:

In order to fulfil its obligations, as set forth in this MOA, MARITIMA or LEASECO, as applicable, shall, in terms acceptable to PETROBRAS and BRASOIL: (i) acquire the legal right, title and power necessary and sufficient to legally and validly transfer [the vessel's] use and ownership to BRASOIL . . . . . .

Documentation acceptable to PETROBRAS and BRASOIL that MARITIMA and/or LEASECO, as applicable, has or can fulfil the terms stipulated in the above paragraph constitute, among others, condition precedent to the TRANSACTIONS. If they are not complied with . . . . .the Contracts and Agreements and other documents contemplated in this MOA . . . . . shall not be signed or executed.

3. UPGRADE

MARITIMA and/or LEASECO, as applicable, undertakes to be fully responsible for the execution and completion of the UPGRADE of [the vessel] in accordance with the SPECIFICATIONS set by PETROBRAS and shall enter into one or more contracts, which will include the following terms:

. . . . . .

8. CONDITIONS

The following shall constitute Condition Precedent to the existence and validity of the TRANSACTION DOCUMENTS:

. . . . . .

c. Evidence and comfort acceptable to PETROBRAS and BRASOIL that MARITIMA or LEASECO, as applicable, has and will continue to comply with its undertakings and covenants as set forth in this MOA to the extent that the same has not been expressly contemplated in the TRANSACTION DOCUMENTS.

9. GENERAL PROVISIONS

The TRANSACTIONS contemplated in this MOA shall be governed by the TRANSACTION DOCUMENTS referred to herein, and by others that may be necessary to give sufficient comfort of the legality, validity and enforceability required with regard to the TRANSACTIONS. Such TRANSACTION DOCUMENTS shall contain the terms and conditions generally described herein, together with other customary reasonable terms and conditions to be agreed . . . . . .

This MOA shall terminate if any condition stated herein is not satisfied unless it is waived by all the parties hereto."

31. The nature and content of the MOA suggest that the parties did intend it to create legal relations, even if only of a provisional nature, but whether it was effective to achieve anything more than an agreed structure for the proposed transaction is another matter. The difficulty arises from the nature of the obligations it purported to impose. The parties to the agreement were Petrobras and Maritima, but the agreement provided in terms for many other bodies to enter into agreements necessary to enable the project to be accomplished. Clause 1, for example, provided for a number of parties, some as yet unidentified, to enter into a 'Participation Agreement' and for the appointment of a trustee to be nominated by agreement between them whose function and responsibilities were likewise not fully defined. Clause 3 set out the terms on which Maritima was to upgrade the vessel in accordance with specifications which were to be set by Petrobras but which were otherwise undefined. Clauses 4 and 5 provided for a 'Lease Agreement with Purchase Option' to be executed between Maritima (or Leaseco) and Brasoil and for a bareboat charter in similar terms to be executed between Brasoil and Petrobras, but in each case the rate of hire (which was one of the critical elements in the whole transaction) was left for agreement at a later date. In view of the fact that neither the specification of work nor the price had been agreed it is difficult to see how the MOA could give rise to a binding obligation to carry through the transaction itself, and if that obligation was lacking, it is difficult to see how any of the other obligations that relate directly to it could have been legally enforceable either. In my view, therefore, the MOA did not give rise to any legally enforceable obligations between the parties.

32. However, I do not think that matters very much as things have turned out because it is clear to me that the purpose of the MOA was simply to provide a framework for the transaction which, if it came into existence, would be embodied in what the MOA itself described as the 'Transaction Documents'. All those involved in the negotiations for the acquisition and upgrading of the vessel were experienced in transactions of that kind and were well aware that in order to satisfy all the parties involved there would have to be a series of inter-related agreements of some complexity. That was recognised by clause 9 of the MOA itself. The parties clearly did not intend the MOA to govern their relationship under those circumstances, except to the limited extent contemplated by clause 8.c. That is hardly surprising. Indeed, when one considers the nature of the project it would be surprising if the agreements necessary to implement it had not been intended to contain a complete statement of the parties' rights and obligations in relation to it.

4. The South Marlim Agreements

33. Although none of the preliminary issues relate directly to the construction of the South Marlim agreements, it is necessary to consider certain aspects of them because they provide the essential contractual background to the Supervision Agreement. Mr. Hancock Q.C. submitted that, since the Supervision Agreement is dated as of 20th June 1997, it should be construed together with the South Marlim agreements as if they were one. That may be correct for many purposes, but if one approaches them as if they had all been negotiated at the same time, there is a danger of failing to understand what the parties were really seeking to achieve, first by the South Marlim agreements and later by the Supervision Agreement itself.

34. The South Marlim agreements, all of which were signed on 20th June 1997, contained the detailed contractual arrangements for the purchase of the vessel, its upgrade for service in the South Marlim oilfield and its deployment by Petrobras. They included the following:

(i) an agreement for the purchase of the vessel by Petro-Deep from SANA ("the Head Purchase agreement");

(ii) an agreement between Petro-Deep and Brasoil for the bareboat charter of the vessel, including the upgrading of the vessel and her eventual sale to Brasoil ("the Bareboat charter");

(iii) an agreement between Petro-Deep and Petromec for the upgrading of the vessel ("the Upgrade Agreement");and

(iv) an agreement between Brasoil and Petrobras for the bareboat sub-charter of the vessel ("the Bareboat Sub-charter").

35. The Bareboat charter contained the following provisions:

"20.1 Petro-Deep's undertakings with regard to upgrade

Petro-Deep undertakes that within twenty one (21) months of 3 March 1997 it will procure that the Vessel is upgraded in accordance with the Specification to the satisfaction of Brasoil and Petrobras.

20.2 Upgrading Contracts

Petro-Deep is entitled to fulfil its undertaking in Clause 20.1 by entering into one or more Upgrading Contracts provided that:

(1) Petro-Deep obtains Brasoil's prior written approval of the Contractor selected for such Upgrading Contract.

(2) Petro-Deep obtains Brasoil's prior written approval of the terms of the Upgrading Contract (other than price).

(3) There is express provision in the Upgrading Contract for the rights and obligations under the Upgrade Contract to be transferable from Petro-Deep to Brasoil or its nominee."

36. The Upgrade Agreement contained the following provisions:

"2 UPGRADE OBLIGATIONS

2.1 Petromec's undertakings with regard to upgrade

Petromec undertakes to Petro-Deep that within twenty-one (21) months of 3 March 1997 it will procure that the Vessel is upgraded in accordance with the Specification to the satisfaction of Petro-Deep, Brasoil and Petrobras.

2.2 Upgrading Contracts

Petromec is entitled to fulfil its undertaking in Clause 2.1 by entering into one or more Upgrading Contracts provided that:

(1) Petromec obtains Petro-Deep's and Brasoil's prior written approval of the Contractor selected for such Upgrading Contract;

(2) Petromec obtains Petro-Deep's and Brasoil's prior written approval of the terms of the Upgrading Contract (other than price);

(3) There is express provision in the Upgrading Contract for the rights and obligations under that Upgrading Contract to be transferable from Petromec to Petro-Deep or its nominee. . . . . .

3 PERFORMANCE SECURITY

Petromec shall, for the benefit of Brasoil, provide or procure the provision of security (whether by guarantee, bond or otherwise) in a form reasonably acceptable to Brasoil for the due and punctual performance of the Upgrade of the Vessel.

4. ***CONSIDERATION***

4.1 In full consideration for Petromec's satisfaction of its obligations to Petro-Deep hereunder, Petromec shall be entitled to receive the Upgrade Basic Hire Payment and Upgrade Other Hire Payment.

4.2 Petromec acknowledges that its recourse against Petro-Deep to recover sums due to it under this Agreement is limited to amounts paid or to be paid into the Petromec Account in accordance with the provisions of the Participation Deed and Security Agency Agreement."

37. All the payments that were to be received by the various parties to the transaction (which included various financial institutions that had made available funds for the vessel's construction) were ultimately to be derived from the bareboat sub-charter hire which was to be assigned to a security agent for distribution in accordance with the agreements. It was essential, therefore, that Petro-Deep as the recipient of charter hire from Brasoil should be immune from any claims which might in any way adversely affect its right to receive that hire. Accordingly, steps were taken within the agreements to *"ring fence*" Petro-Deep to ensure that it could not incur liabilities to any of the other parties to the transaction.

38. Petromec was introduced as the contracting party to the Upgrade Agreement for two reasons. First, the negotiations had been complex and prolonged and by June 1997 there was considerable pressure from all concerned to close the transaction. That could not be achieved, however, until Petro-Deep's position could be secured which in turn required it to enter into a contract for the upgrade of the vessel. It was necessary for there to be a contracting party responsible to Petro-Deep for the upgrade work as a whole. The introduction of Petromec as upgrade contractor enabled the final element of the transaction to be put in place and closing to occur on 20th June. Contracts for the shipyard work and for the supply of equipment could then be placed by Petromec as it became convenient to do so. The contract with Davie for the shipyard work was not signed until 14th July 1997. Secondly, it was an essential element of the transaction that a company ultimately controlled by Maritima would be responsible for managing the

upgrade work and would derive a profit (or loss) from the transaction to the extent that the cost of the necessary work and equipment was less than the amount it was due to receive out of the hire. Petromec was incorporated to carry out that role.

39. Neither Petrobras nor Brasoil was a party to the Upgrade Agreement and Ms Prevezer submitted that the parties to the original transaction contemplated that the 'construction risk', that is the risk of delay and defective or incomplete work, was intended to rest with Brasoil and Petrobras. Petrobras was willing to accept those risks, she submitted, because it was entitled through Brasoil to approve all contracts with suppliers and sub-contractors (and to have those contracts transferred to it, if it so wished) and could thus exercise effective control over the work.

40. The June 1997 Agreements were structured with considerable care to satisfy a variety of different interests. Petrobras was certainly content to assume many of the substantial risks of the project. For example, it was content to take over the platform "*as is, where is*" and was content to charter it on *"hell or high water"* terms which rendered it liable to continue paying hire under all imaginable circumstances. It would not be surprising, therefore, if Petrobras had agreed to accept the risks attached to the upgrade itself, provided it could exercise control over the project.

41. If it had been the parties' intention that Petromec should incur any liability to Petrobras or Brasoil in relation to the upgrade one or other of them would undoubtedly have been made parties to the Upgrade Agreement, but that might have been thought by some to risk compromising the ring fencing of Petro-Deep which was critical to the transaction. Instead, the only party to which Petromec undertook any liability was Petro-Deep and by clause 2.2 of the Agreement it was entitled to perform its obligations by entering into sub-contracts for work and equipment with parties, and on terms, approved by Petro-Deep and Brasoil. In the context of these agreements that can only mean that Petromec fully performed its obligations by entering into approved sub-contracts and could not be held liable for delay or for incomplete or defective work. In my view the scheme of the transaction did therefore effectively impose on Petrobras and Brasoil risks of that kind since there was no other party to the transaction to whom either of them could look for relief in respect of them. However, since by clause 3 of the Agreement Petromec was bound to provide security for the performance of the contract for the benefit of Brasoil, in commercial terms it was not entirely free of responsibility for the performance of the upgrade work.

5. The Supervision Agreement

42. The decision to deploy *P-36* in the Roncador field had a profound effect on the nature of the project. It was essential to press ahead with the upgrading of the vessel as quickly as possible, but at the end of February 1997 when the board of Petrobras approved the Roncador project no technical specification existed to provide the basis for the necessary engineering development, and indeed further information became available even as the engineering design work was being carried out. This meant that the project in its revised form could only be made to work if Petrobras and Maritima were willing to show a high degree of co-operation and Petrobras agreed to accept responsibility for the financial consequences of the change.

43. Even before the ink was dry on the South Marlim agreements Petrobras and Maritima had begun to consider what further agreements were needed to give effect to the project as originally envisaged as well as the change from South Marlim to Roncador. It was recognised that two broad aspects of their relationship had to be covered: Brasoil's involvement in the supervision and approval of the work (which was essential if the agreements gave it no effective rights against Petro-Deep or Petromec) and the changes to the financial arrangements needed to accommodate the new project. During the autumn of 1997 drafts of an agreement passed between the parties which reached their final form in early 1998. However, the agreement itself was not signed until August 1998.

44. The Supervision Agreement is dated *"as of 20th June 1997"* and it is common ground that it was intended to be read together with and as part of the South Marlim agreements. It is also common ground, therefore, that it was intended to regulate the parties' relationship with respect to events that had occurred between June 1997 and August 1998. Petro-Deep, Petromec, Brasoil and Petrobras were all parties to the agreement which contained, among others, the following provisions:

"Whereas:

(A) . . . . . Petro-Deep has undertaken to Brasoil to procure that the Vessel is upgraded in accordance with the Original Specification to the satisfaction of Brasoil and Petrobras within a specified period; and

(B) . . . . . Petromec has undertaken to Petro-Deep to ensure the Vessel is upgraded in accordance with the Original Specification to the satisfaction of Petro-Deep, Brasoil and Petrobras within a specified period; . . . . . .

2 Shipyard Contract

Subject to the rights of supervision herein granted:

2.1 Brasoil hereby approves the terms of the Shipyard Contract for all purposes under the Bareboat Charter and Purchase Agreement.

2.2 Petro-Deep hereby approves the terms of the Shipyard Contract for all purposes under the Upgrade Agreement

3 General Right of Supervision

Petrobras, Petro-Deep and Petromec hereby grant to Brasoil or its nominee certain rights of supervision and approval in respect of the carrying out of the work . . . . . .

5 Specific Rights of Supervision

5.1 Brasoil shall be entitled to approve (or otherwise):

(i) the Upgrade Contractors;

(ii) the Contracts other than price:

(iii) any plans, drawings specifications, calculations and other matters required under the terms of the Contracts and changes thereto;

(iv) the material, workmanship and manner of construction and installation of the Work;

(v) any claim from any of the Upgrade Contractors made prior to the Actual Delivery Date of the Vessel for an extension of time for the completion of the Work. . . . . .

9 Petromec's Obligations

9.1 Petromec shall . . . . . .

9.1.4 ensure that the Upgrade is completed in accordance with the Specification, irrespective of default by any Upgrade Contractor. . . . . .

10 Change Orders

10.1 Both for the purposes of this Agreement and on an ongoing basis, Brasoil shall be entitled to instruct Petromec to propose:

10.1.1 any alteration to the Amended Specification; or

10.1.2 any change to any plan, drawing, specification, calculation or other document submitted to Brasoil pursuant to this Agreement; or

10.1.3 any alteration to the arrangement for the maintenance and repair of the Vessel prior to the Actual Delivery Date.

10.2 On receipt of an instruction pursuant to Clause 10.1 Petromec shall be obliged to use its best endeavours to agree the alteration(s) or change(s) set out in that instruction with the relevant Upgrade Contractor(s) pursuant to the terms of the relevant Contracts. If Petromec and the relevant Upgrade Contractors fail to agree on the alteration(s) or change(s) within fourteen (14) days of receipt by Petromec of such proposal, Brasoil shall be entitled to require Petromec to take such steps as may be appropriate to enable the alteration or change to be effected including (but without prejudice to the foregoing) replacing the relevant Upgrade Contractor(s).

11 Amendment to Specification

11.1 It is hereby agreed that, pursuant to Clause 10 hereof, the Original Specification is amended by:

(i) Substituting for the General Technical Specification for the South Marlin Field in document ET.3010.38-1200-940-PPC-001 the Revision A which contains the requirements for the Roncador Field.

(ii) Adding the Metocean Data - Roncador - contained in document ET.3010-56-1200-941-PPC-001, Revision 0.

12 Compensation

12.1 In consideration of Petromec's agreement to upgrade the Vessel in accordance with the Amended Specification Brasoil agrees to pay to Petromec an amount equal to the reasonable extra cost (if any) to Petromec of Upgrading the Vessel in accordance with the Amended Specification over and above the cost that Petromec might reasonably have incurred in Upgrading the Vessel in accordance with the Original Specification.

12.2 In the case of any further alterations or changes instructed by Brasoil pursuant to Clause 10 hereof, Brasoil agrees:

(i) to pay to Petromec the reasonable costs (if any) incurred by Petromec and its contractors in progressing the engineering in accordance with such Specification as was agreed before the alteration or change;

(ii) to pay to Petromec an amount equal to the reasonable extra cost (if any) to Petromec of Upgrading the Vessel in accordance with the Specification as altered or amended; and

(iii) to extend the date by which Petromec must complete the Upgrade.

12.3 The additional costs referred to in Clauses 12.1 and 12.2 above will become due and payable on the production by Petromec of evidence of expenditure satisfactory to Brasoil and Brasoil being satisfied that such costs were reasonable and properly incurred.

12.4 Brasoil agrees to negotiate in good faith with Petromec the extra costs referred to in Clauses 12.1 and 12.2 above and the extra time referred to in Clause 12.2 above and upon the determination of the same Brasoil and Petromec agree to enter into one or more addendums to this Agreement specifying the amounts to be paid by Brasoil to Petromec pursuant to this Clause 12 in good time for Petromec to meet its obligations to its contractors and specifying the date by which Petromec must complete the Upgrade of the Vessel in accordance with the Amended Specification."

(a) Clause 9.1.4

45. The first issue that arises in relation to the Supervision Agreement is the construction and effect of clause 9.1.4. Mr. Hancock submitted that its terms are quite clear: whatever may have been the position under the original South Marlim agreements, clause 9.1.4 imposed an obligation on Petromec to ensure that the upgrade was completed in accordance with the contract and on time. On that basis it seeks to recover from Petromec damages for delay in the completion of the work. Ms Prevezer, on the other hand, submitted that to impose an obligation of that kind on Petromec would involve a fundamental change in the nature of the parties' relationship. Clause 9.1.4 was introduced into the draft in November 1997 and was not the subject of any detailed negotiation. It cannot have been the parties' intention to make such an important change without any discussion.

46. I have already described the commercial background to the Supervision Agreement and little further assistance on this question is to be gained either from the contemporaneous documents or the evidence given by the witnesses. In the end it comes down to a matter of construction. It can be seen that the agreement falls into three parts: clause 2 contains specific approvals of the contract with Davie, clauses 3 to 9 give Brasoil the right to supervise and control the course of the work and clauses 10 to 12 deal with amendments to the original specification, both by the substitution of the Roncador specification for the South Marlim specification and by way of variation of the Roncador

specification itself. Accordingly, whereas clauses 10 to 12 were only necessitated by the change from South Marlim to Roncador, clauses 2 to 9 cover ground that is equally appropriate to the original project. Ms Prevezer submitted that clause 9.1.4 merely repeats in different language the substance of clause 2.1 of the Upgrade Agreement and that the obligations to which it refers were capable of being, and were, fully performed by Petromec's entering into sub-contracts for the work as envisaged by clause 2.2.

47. Clause 9.1 as a whole is not free from difficulty. Paragraphs 9.1.1 to 9.1.3 all provide obvious and necessary support for the rights of supervision given to Brasoil under clauses 5 and 6, but at first sight paragraph 9.1.4 appears to be of a different nature altogether. Moreover, its language does not reflect the change in the nature of the project: it refers to the "Specification" (which was defined in the Upgrade Agreement as the specification to be annexed to the Bareboat Sub-Charter Agreement, i.e. the South Marlim specification), whereas the Supervision Agreement refers only to the "Original Specification" and the "Amended Specification". Paragraph 9.1.4 apparently obliges Petromec to ensure that the "Upgrade" is completed in accordance with the "Specification", but since "Upgrade" is defined in this agreement as meaning the upgrading of the vessel in accordance with the Amended Specification, it can be argued that "Specification" should here be read as "Amended Specification".

48. Despite that, I think that the inclusion of an obligation to complete the upgrade in accordance with the specification regardless of a default by any sub-contractor can also be regarded as supporting the rights given by clause 5. The parties have taken care in this agreement to ensure that Brasoil does not displace Petromec in its dealing with sub-contractors, but exercises its rights of supervision through it. Thus, by clause 5.1 Brasoil has the right to approve or reject materials and workmanship and to approve or reject claims for extensions of time for the completion of the work, but by clauses 5.2, 5.3 and 5.4 it is obliged to exercise that control through Petromec which remains the party to the relevant sub-contract. The expression of an obligation on the part of Petromec to ensure that the upgrade is carried out in accordance with the specification can be seen as providing support for its enforcement of the obligations of sub-contractors. It does not follow, however, that Petromec loses the benefit of clause 2.2 of the Upgrade Agreement.

49. Further support for this conclusion is to be found in clause 2 of the agreement. As far as I can see, the only purpose of including that clause was to provide in a formal manner the written approval of the terms of the shipyard contract of the kind contemplated by the Bareboat Charter and the Upgrade Agreement as part of the mechanism by which Petro-Deep and Petromec respectively were entitled to perform their obligations in relation to the upgrade. If that is correct, it supports the conclusion that clause 9.1.4 was not intended to override clause 2.2 of the Upgrade Agreement and it would make no sense for the parties to have inserted a new and more onerous obligation in clause 9.1.4 in relation to the upgrade required for the Roncador project.

50. The only other indication within the agreement is to be found in clause 12.2(iii) which provides for extensions of the time for completion. Mr. Hancock submitted that this reinforces the conclusion that Petromec was under more than a nominal obligation to ensure that the work was carried out within a specific time. I agree that that clause is consistent with the view that Petromec was bound to ensure that the upgrade was completed within a defined period, but that obligation arose under the Upgrade Agreement and was capable of being performed in the manner provided for by clause 2.2. In my view the existence of clause 12.2(iii) involves no more than a recognition that changes in the work might call for changes to the 21 month period provided for in clause 2.1 of the Upgrade Agreement which might in turn affect the terms on which it would be appropriate to place contracts with suppliers and sub-contractors. I do not think that it provides sufficient support for the conclusion that the Supervision Agreement was intended when read in conjunction with the South Marlim agreements to impose an obligation on Petromec for any delay in completion.

51. I think it is important to bear in mind that the Supervision Agreement was intended to be an addition to, and to form an integral part of, the South Marlim agreements. That did not of itself prevent the parties from modifying the original structure of the transaction, as they did by introducing the modifications required to accommodate the change to the Roncador project, but it does suggest that if the parties had intended to vary the parties' obligations in the manner for which Mr. Hancock contended they would have done so in much clearer terms. In the end I have reached the conclusion that clause 9.1.4 does no more than re-state the obligation which Petromec undertook in clause 2.1 of the Upgrade Agreement leaving it free to fulfil that obligation in the manner set out in clause 2.2.

52. In the alternative, however, Ms Prevezer submitted that Petrobras and Brasoil are estopped from contending that the Supervision Agreement renders Petromec liable for delay and defective work because all those involved in the project acted throughout on the common assumption that it was under no such liability.

53. Discussions on the form of what eventually became the Supervision Agreement began in September 1997. It is apparent from a memorandum sent by Linklaters on behalf of Petrobras to Petromec's lawyer, Mr. Devine, and copied to Mr. Justi that at that stage Petrobras had agreed to accept the construction risk of the project on the basis that its right to supervise the work would enable it to manage that risk. On 2nd October Mr. Davies of Linklaters sent a fax to Mr. Hawksley commenting on a further draft of the agreement. He insisted that Brasoil should have the right to grant extensions of time to upgrade contractors because delay in completion would delay its use of the vessel whereas it would have no effect on Petromec. When he replied on 6th October Mr. Hawksley confirmed his understanding that the purpose of the Supervision Agreement was to ensure that the upgrade of the vessel was carried out in accordance with the specification and that it was not intended to change the commercial nature of the transaction. Later on, after the Supervision Agreement had reached its final form, including clause 9.1.4, Linklaters drafted a memorandum describing the transaction for the benefit of potential lenders. This contained a summary of

the original South Marlim project which included a passage referring to Brasoil's right to suspend payment of part of the hire if the vessel were not completed within the 21 month period prescribed by the contract and to the fact that it had waived that right. The memorandum also summarised the rights and obligations of Petromec, including its undertaking to Petro-Deep to complete the upgrade within 21 months. There is no reference to Petromec's having any obligation in that respect (or in respect of defective work or materials) to either Petrobras or Brasoil.

54. In December 1998, when negotiations were in progress to obtain further funding for the project, Mr. Gibbs of Linklaters sent Mr. Hawksley a draft of a proposed amendment to the loan agreement between Petromec and Chase Manhattan which had been made a year earlier. It included a new clause (clause 21.4) which obliged Petromec to indemnify Brasoil against any losses incurred in connection with the upgrade of the vessel in accordance with the Upgrade Agreement. Mr. Hawksley objected to the inclusion of that clause on the grounds that it represented a major departure from the existing position under which Petromec could fulfil its obligations by entering into contracts with sub-contractors and suppliers and he ensured that a comment confirming that it had done so was included in a letter sent by Mr. Reis to Mr. Jorge two days later. In the event clause 21.4 was removed.

55. In May 1999 Mr. Gibbs produced another memorandum describing the background to, and nature of, the transaction for the purpose of enabling EDC to instruct lawyers in Brazil. That memorandum did not deal directly with Petromec's obligations, but when describing the proposals for obtaining finance for the project Mr. Gibbs referred to the obligation of Petrobras to indemnify Petromec on a "dollar for dollar basis" for any amounts (including finance costs) that it was obliged to pay in connection with the upgrade. A copy of the memorandum was sent to Mr. Hawksley for his comments. No suggestion was made that Petromec might be liable for delay or deficiencies in the completion of the work until well after the vessel had been delivered to Petrobras.

56. The principles of estoppel by convention are to be found in ***Amalgamated Investment & Property Co. Ltd v Texas Commerce International Bank Ltd*** [1982] 1 Q.B. 84 and **Norwegian American Cruises A/S v Paul Mundy Ltd (The 'Vistafjord')** [1988] 2 Lloyd's Rep. 343. At their heart lies an agreed assumption, whether of fact or law, which each party knows is held by the other and which forms the basis on which they have subsequently conducted their dealings so as to make it unjust to allow either of them to challenge the assumption later on: see per Bingham L.J. in ***The Vistafjord*** at pages 351-352 approving a passage in the judgment of Peter Gibson J. in ***Hamel-Smith v Pycroft & Jetsave Ltd*** (unreported).

57. Mr. Hancock submitted that the exchanges to which I have referred are not sufficient to establish that the parties shared a common assumption that Petromec was not liable for delay, but I am unable to accept that. Whatever residual obligations Petromec may have incurred under the South Marlim agreements in relation to the upgrade, they did not extend beyond performing its contracts with sub-contractors and suppliers and not interfering with the progress of the work. Provided it did that, Petromec was not liable for delay in the completion of the work or defective workmanship or materials. The correspondence between the parties makes it quite clear that throughout the time the Supervision Agreement was being negotiated that was the common understanding of all concerned and it formed the basis on which they entered into the Supervision Agreement.

58. Mr. Hancock then submitted that even if that were so, there is no evidence that Petromec acted on that assumption in a way that would make it unjust for Petrobras to insist on the strict terms of the agreement. Again, I cannot agree. It is idle at this stage for anyone to speculate on what precise steps Petromec might have taken if it had thought when the Supervision Agreement was signed, or indeed at any later time, that it might be liable for any delay in completion of the work. In Petromec's eyes that would have fundamentally altered the basis of the transaction. I do not think that it would have been willing to continue the project on that basis or that Petrobras, which was under considerable pressure to bring the platform into production as quickly as possible, would have tried to insist on its doing so. In view of the fact that the whole project was carried out on the basis of a common assumption that Petromec was not liable for delay or deficiency in completion of the upgrade, it would be quite unfair in my view for Petrobras or Brasoil now to be allowed to resile from it. Accordingly, even if I am wrong in the conclusion I have reached as to the construction of clause 9.1.4, I do not think that Petrobras or Brasoil can rely on it to hold Petromec liable.

(b) Clause 12.1

59. It was recognised from the outset that the upgrade required to make the vessel suitable for the Roncador field was likely to cost more than that which had been necessary for South Marlim. Quite how much more was uncertain because the engineering design was still being developed, but as additional data became available from the field it became clear that it would be necessary to provide additional equipment and the structure to carry it. Petrobras accepted that it should bear any additional costs resulting from the change in the project and clause 12 of the Supervision Agreement makes provision for that.

60. Clause 12.1 deals with the additional cost of the changes introduced by the substitution of the Roncador specification for the South Marlim specification. It provides for Brasoil to pay Petromec *"an amount equal to the reasonable extra cost (if any) to Petromec of upgrading the vessel . . . . . over and above the cost that Petromec might reasonably have incurred in upgrading the vessel in accordance with the original specification."*

Petromec contended that "cost" includes not only the additional cost of work and materials, but also overheads of all kinds and an element of profit in respect of the additional management of the project. Petrobras, on the other hand, says that "cost" means cost and does not include any element of profit.

61. Ms Prevezer submitted that the change from South Marlim to Roncador was so fundamental that the parties agreed to move from what had in effect been a fixed price contract to a "cost plus" contract, that is, a contract under which Petromec was to be paid the whole of the additional cost incurred in carrying out the work plus a percentage in respect of profit. She therefore submitted that "cost" in clause 12.1 should be construed as including a reasonable profit element.

62. Although that would have been a perfectly reasonable agreement to make, I am unable to accept that it is what this clause means. Taken on its own the word "cost" naturally refers to the expenses incurred by the contractor rather than the profits that he might expect to earn over and above those expenses, but when clause 12.1 is read as a whole the position is put beyond doubt. The expressions "*extra cost (if any) to Petromec*" and "*the cost that Petromec might reasonably have incurred*" can only refer to costs incurred in carrying out the work and are quite inappropriate to include any element of profit. This conclusion is further reinforced by the terms of clause 12.3 under which Petromec was bound to produce evidence of expenditure and to satisfy Brasoil that it was reasonable. I do not find that surprising. Under the original contract Petromec was to receive a fixed price in the form of an agreed part of the charter hire in return for the upgrade of the vessel. It had estimated the cost of the work and had calculated the profit that it could expect to make if everything went according to plan. Although Petrobras recognised that it had to bear the increased cost generated by the change to Roncador, there is nothing to suggest that at the time the Supervision Agreement reached its final form either party wanted to upset the basic financial arrangements established by the South Marlim agreements. Neither party knew at that stage exactly how much additional work would be involved and by agreeing that Petrobras would bear the additional costs of the Roncador project they ensured that Petromec retained whatever profit it had already secured while limiting the financial liability of Petrobras to any reasonable additional costs.

63. However, I think Ms Prevezer was right in submitting that the additional costs recoverable under clause 12 do not relate only to the direct costs of work and equipment. Clause 12.1 contains no limitation on the type of costs that Petromec is entitled to recover and in my view it was clearly the parties' intention that it should recover the whole of the additional costs incurred as a result of the change in the nature of the project, provided only that they were reasonable. Accordingly, I think that Petromec was entitled to recover in addition to direct costs such as payments to sub-contractors and suppliers costs in the form of additional overheads of all kinds, including additional financing costs, that resulted from the change in the project.

6. The first set of variation orders

64. Clauses 12.3 and 12.4 of the Supervision Agreement contained a procedure for the assessment and payment of the additional costs recoverable under clauses 12.1 and 12.2. They placed the onus on Petromec to demonstrate that the additional costs in respect of which it sought reimbursement had been reasonably and properly incurred. They did not stipulate any particular method by which that should be done, but I think it likely that the parties assumed that variation orders of the kind with which they were both familiar would be employed for that purpose.

65. In the event, however, when seeking payment for the additional cost of the Roncador project Petromec did not follow the procedure set out in clause 12. During the latter part of 1997 it had encountered difficulties in obtaining funds from EDC and although interim arrangements had been made with Chase Manhattan in December 1997, there was considerable pressure on it to obtain additional funds needed to keep the work going. One way of obtaining those funds was to submit claims for additional costs to Brasoil. By March 1998 the design changes had been sufficiently identified to enable Petromec to estimate the cost of carrying out the work, although the work itself would not be done until some months later. In those circumstances Petromec decided to submit variation orders to Brasoil in support of an application for payment, even though a large proportion of the costs associated with them had yet to be incurred.

66. Petromec submitted its first set of variation orders to Brasoil in three parts under cover of letters dated 27th March, 17th April and 21st April 1998. These proposed variations which reflected substantial changes in the design of the platform which Petromec considered necessary to accommodate the different characteristics of the Roncador field, particularly the increased water depth, faster current and increased production capacity. The variation orders contained estimates of the number of hours that would be required for detailed engineering design and procurement, but not the cost of the shipyard work, nor, in most cases, the cost of the additional equipment itself. A single global figure was put forward by Petromec in relation to each variation order as the additional cost of completing the work described in it. The total amount claimed in respect of the first set of variation orders was a little over US$80 million. However, it was impossible to calculate the eventual cost of the work with any precision at that stage and Mr. Efromovich candidly accepted that what Petromec was putting forward was a price for completing the job. In effect, he regarded each variation order as a quotation and if Brasoil had accepted it, or had been willing to agree an acceptable figure, Petromec would not in his view have been entitled to be paid any more for that work, even if the costs ultimately exceeded its expectation. The variation orders were left with Brasoil for evaluation. Although each one was priced, in the sense that a figure was put forward for the work to which it referred, Petromec did not provide any detailed costings or other support for the sums it claimed. In effect, therefore, Brasoil was left to cost the work for itself and to decide whether to accept Petromec's figure or propose a different one.

(a) Discussions with Petrobras

67. Following the submission of the first set of variation orders Mr. Padilla, who was responsible for commercial aspects of the project on behalf of Petromec, had a number of discussions with Mr. Justi in an attempt to reach agreement on

the amount to be paid to Petromec. They failed to reach agreement, however, because the amount offered by Petrobras fell a long way short of what Petromec was seeking. Accordingly, Mr. Efromovich arranged a meeting with Mr. Justi and the general superintendent of the Engineering department, Mr. Fonseca, at which he hoped to reach an acceptable agreement of some kind.

68. The meeting, which was attended by Mr. Efromovich, Mr. Padilla, Mr. Fonseca and Mr. Justi, took place in Mr. Fonseca's office sometime during the first half of June 1998. The witnesses' accounts of the meeting differ in a number of respects. Mr. Efromovich and Mr. Padilla said that Mr. Justi had calculated that the information provided by Petromec did not support a payment of more than US$38 million, but that Mr. Fonseca had said he was prepared to pay US$43 million and sent Mr. Padilla and Mr. Justi to another room to find a way of attributing that amount to the variation orders that had been submitted. They were able to produce a figure of US$42,972,000. Mr. Fonseca and Mr. Justi, on the other hand, said that the figure of US$42.9 million resulted from calculations carried out by Mr. Jorge's team of engineers and was the most that Petrobras could agree to pay on the basis of the material before them. On this point I accept the evidence of Mr. Fonseca and Mr. Justi, partly because I can see no plausible basis on which Mr. Fonseca might have simply agreed to pay an additional US$5 million, but mainly because one of the documents before me was a schedule prepared by Mr. Jorge analysing the variation orders and setting against each one the amount that he would be prepared to recommend that Petrobras should pay. The total comes to US$42,972,000.

69. More importantly, perhaps, for present purposes, Mr. Efromovich and Mr. Padilla both said that they had made it clear that Petromec would only accept the proposed payment of US$ 42.9 million on the understanding that it could seek a further payment at a later date when the position became clearer, whereas Mr. Fonseca and Mr. Justi both said that the discussions had all revolved around the amount of a final payment. Before seeking to resolve that issue, however, it is necessary to consider what happened next.

70. On 16th June 1998 Mr. Fonseca and Mr. Carneiro, then executive superintendent of the Exploration and Production department, sent a joint memorandum prepared for them by Mr. Justi to two of the directors of Petrobras, Mr. Vilarinho and Mr. de Agostini. In that memorandum they summarised the changes in design and equipment needed to make *P-36* suitable for operation in the Roncador field as set out in the variation orders submitted by Petromec and proposed that the board be asked to recommend an additional payment to Petromec of US$42,972,000. They further proposed that US$12,891,600 should be released immediately and the balance on delivery of certain items of equipment. Attached to the proposal was a draft letter from Petrobras to Petromec in the following terms which they also invited the board to approve:

"As provided for in clause 12.4 of the Supervision Agreement, we hereby confirm the alterations in the scope of the construction work as per PETROMEC letters . . . . . .

2. As per clauses 10,11 and 12 of said Supervision Agreement, the agreed price of the alterations is US$42,972,000.00, to be paid as follows:

- *30% upon your formal acceptance to the terms of this letter;*
- *45% upon delivery of the turbocompressors to the shipyard;*
- *25% upon delivery of the manifolds, launchers and receivers to the shipyard.*

3. As a result of these alterations, the time schedule . . . . is extended by three months from 21 to 24 months. . . . . .

4. Kindly return a copy of this letter with your and PETRO-DEEP's agreement to the above conditions."

71. In due course these proposals were approved by the board of Petrobras and on 9th July 1998 Mr. Justi wrote to Petromec in the terms of the draft. Mr. Efromovich refused to counter-sign it because it did not contain any language that recognised Petromec's right to receive any further payment in respect of the work covered by the variation orders. As a result there was a telephone conversation between Mr. Efromovich and Mr. Justi which led to the letter's being counter-signed by Mr. Efromovich on behalf of Petro-Deep and by Mr. Padilla on behalf of Petromec.

72. Again, there is some dispute about what passed between Mr. Efromovich and Mr. Justi in the course of that telephone conversation. According to Mr. Efromovich, Mr. Justi was very anxious for him to sign the letter, saying that there would be a "big mess" if he refused to do so. When Mr. Efromovich said that he wanted the wording changed to reflect his discussion with Mr. Fonseca Mr. Justi said that it had to be signed as it was and that if Mr. Efromovich refused to sign it there would be no more money and the work would stop. Mr. Efromovich said that Mr. Justi had advised him to take the US$43 million and discuss the figures again in the future; he said that the letter "would not be used", by which Mr. Efromovich understood him to mean that Petrobras would not rely on it to refuse any further payment.

73. Mr. Justi agreed that he had urged Mr. Efromovich to sign the letter, pointing out that he had to sign it to enable payment to be made. He said that he made it clear to Mr. Efromovich that the purpose of the letter was to establish the amount payable in respect of the first set of variation orders and that although Petromec could still submit variation orders for further modifications, it would not be possible for it to obtain additional payment for the same work just because the costs turned out to be higher than had been estimated.

74. Ms Prevezer submitted that on this, as on many other issues, the evidence of Mr. Efromovich and Mr. Padilla was to be preferred to that of Mr. Justi and Mr. Fonseca. She was especially critical of Mr. Justi whom she described as partisan and generally unreliable. She submitted that by contrast Mr. Efromovich and Mr. Padilla were candid and reliable witnesses and relied on the fact that Mr. Padilla is no longer associated with the Maritima group and thus has no incentive to distort his account.

75. There undoubtedly were some instances in which Mr. Justi's evidence was open to criticism, but I do not think that he was setting out to mislead the court. All the witnesses faced the difficulty that the events that they were asked to describe occurred between four and six years ago. Over such a period memories can easily become distorted without there being any intention to mislead. This difficulty, which affected witnesses called by both sides, was compounded by the fact that many of the conversations to which they referred were not recorded or directly referred to in contemporaneous documents, or at any rate not in documents that were in evidence. (Ms Prevezer made many complaints in the course of the trial about the disclosure given by Petrobras, all more or less justified, but despite some obvious shortcomings, I am not satisfied that there was any deliberate suppression of documents known to be material.) Moreover, it is necessary to remember that although many of the principal witnesses gave evidence in English, none of them except Mr. Hawksley speaks English as his first language and that sometimes gave rise to difficulty both in understanding questions and formulating responses which properly reflected what they wanted to say. I should add that although all the witnesses provided written statements in English, some clearly did not have a sufficient command of the language to make that appropriate. In these circumstances I am unable to accept that one witness's evidence is always to be preferred to that of another. As usual, it is necessary to consider all the evidence relating to each issue individually in order to decide where the truth lies.

76. At the time Mr. Efromovich certainly gave those involved in the project on behalf of Petromec, notably Mr. Padilla, Mr. Hawksley and Mr. Reis, the impression that the door was not finally closed on additional payments for the first set of variation orders and his position was later reflected in correspondence between the parties early in 1999 when Petromec sought additional funding for the project from Petrobras. Petrobras, however, always insisted that a binding agreement was reached when Petromec counter-signed and returned the letter of 9th July 1998 and that the sum of US$43 million represented the final amount payable.

77. It is important in my view not to lose sight of the commercial background to the exchanges between the parties in June 1998 relating to these variation orders. Mr. Efromovich had enjoyed a long and successful business relationship with Petrobras. He knew many of the managers in the Engineering department, in particular Mr. Justi, well and a substantial measure of trust existed between them. It was not uncommon on projects of this kind for the parties to sit down together after everything had been completed to negotiate claims for additional payment resulting from changes to the work. In June 1998 Petromec had an urgent need for funds to enable it to continue the work and Petrobras was concerned to ensure that there was no delay to the project. However, approval for the payment of an amount as large as that sought by Petromec could only be given by the board of directors and the Engineering department could not seek the board's approval without providing proper support for its recommendation. It may be that in costing the variations Mr. Jorge and his team erred on the side of frugality, but their figures were the only ones available to Mr. Justi and Mr. Fonseca when they went into their meeting with Mr. Efromovich and Mr. Padilla. Everyone recognised that costing the whole job was a very difficult and imprecise exercise on the information then available, but that was the basis on which Petromec put forward its claim and on which it invited Petrobras to deal with it.

78. Ms Prevezer submitted that Mr. Efromovich would never have been willing to give up the best part of US$40 million, but the figure put forward by Petromec was a bid rather than a detailed calculation of additional costs and was not supported by any calculations. One cannot assume that it would have survived detailed scrutiny unscathed. Moreover, Petromec was under severe financial pressure. I am satisfied that at the meeting Mr. Efromovich recognised that he would not persuade Mr. Fonseca to approve more than the US$43 million then on offer, but that he made it clear that he regarded it as merely a payment on account. Mr. Fonseca did not formally agree to that, but probably did encourage Mr. Efromovich to think that at the end of the project a further payment might be negotiated to ensure that Petromec did not lose out.

79. There is nothing to suggest that there was any mention at the meeting of the way in which the additional payment would be formalised and I am satisfied that the letter of 9th July came as a surprise to Mr. Efromovich. Mr. Justi said that it emanated from Petrobras' legal department and I see no reason to doubt that. The form of the document, with its reference to clause 12 of the Supervision Agreement, suggests that that may well have been its source and that someone had noticed that clause 12.4 called for a formal addendum specifying the amount to be paid. Mr. Efromovich was unwilling to counter-sign the letter, partly because he was not expecting to receive a formal document of that kind and partly because it did not expressly allow for the possibility of a further payment. However, he recognised the force of Mr. Justi's point that no payment could be made unless Petromec and Petro-Deep did sign. I think that Mr. Efromovich was willing to take what he could under the circumstances in the reasonable confidence that a better settlement could be negotiated after the successful completion of the project.

(b) The effect of the letter of 9th July

80. However, it still remains necessary to consider the status and effect of the letter of 9th July since Ms Prevezer submitted that it was not regarded at the time as a document of any legal significance, merely as the means of releasing the funds. She drew my attention to the fact that the letter was written on Petrobras writing paper and signed by Mr. Justi as project manager for the Albacora field, whereas responsibility for additional costs arising out of variations, including the change from South Marlim to Roncador, actually lay with Brasoil. The recommendation by Petrobras to Brasoil that it should approve the variations at an additional cost of US$43 million was not made until 20th July and was formally accepted by the board of Brasoil only on 29th July. Meanwhile Petromec had already submitted invoices for the first two instalments to Petrobras on 10th and 21st July.

81. Despite these apparent defects in the formalities of the decision-making process, I find it difficult to accept that the letter was not intended to have any legal significance. It is drafted in formal terms and specifically asks that it be counter-signed to indicate agreement to its contents. It was put before the Petrobras board for approval as part of the proposal supporting the payment of a large sum of money and I have no doubt that Petrobras regarded it as a formality, but an effective one for all that. Mr. Efromovich did not say that he regarded it as having no significance and if that had been his view it is less easy to understand why he should have been reluctant to sign it. I am unable to attach any significance to the fact that it was written on Petrobras paper. I have already explained the relationship between Petrobras and Brasoil and Mr. Efromovich and Mr. Padilla were well aware that although Petrobras used Brasoil as a vehicle for transactions of this kind, Brasoil's functions were performed by employees of Petrobras such as Mr. Justi and Mr. Fonseca. They were also aware that any payments that needed to be made by Brasoil had to be approved and funded by Petrobras. In the context of this project no one can have been in any doubt that letters written by Mr. Justi on Petrobras paper were sent on behalf of both Petrobras and Brasoil and that a letter agreement in that form was intended to be binding on both companies.

82. Ms Prevezer submitted that on its true construction the letter of 9th July contained an agreement as to the amount to be paid in respect of variations based on the information submitted to Petrobras at the time, so that a further claim might be made if and when additional information became available. However, that is not what it says and it would be surprising if it had done so because very little information about the details of the work or its cost had been made available. As I have already observed, Petromec did not set out to identify and substantiate additional costs that had already been incurred; it simply put forward a global price for the job and invited a response from Petrobras. There was no attempt on the part of Petromec to justify a minimum sum pending a more detailed presentation and I do not think that the letter can be read as if that had been the nature of the exercise undertaken by the parties.

83. Finally, Ms Prevezer submitted that, even if the letter agreement would otherwise be binding, Petrobras and Brasoil cannot rely on it, having given an assurance that it would not be enforced against Petromec in accordance with its terms. The proposition that a person who induces another to enter into an agreement by assuring him that it will not be enforced in a certain way or under certain circumstances may be bound by that assurance is not controversial. Usually, if the assurance was made with the intention that it be relied on, it will give rise to a collateral contract: see ***City and Westminster Properties (1934) Ltd v Mudd*** [1959] Ch. 129, ***Mendelssohn v Normand Ltd*** [1970] 1 Q.B. 177 and *Brikom Investments Ltd v Carr* [1979] Q.B. 467. The argument thus raises a number of points: what exactly did Mr. Justi say to Mr. Efromovich? was whatever he said intended to have legal significance? and if it was, did he have authority to give any such assurance on behalf of Petrobras or Brasoil?

84. Although I am satisfied that Mr. Justi did seek to reassure Mr. Efromovich that signing the letter would not preclude negotiations for an additional payment after the project had been completed, I am unable to accept that he gave any assurance that Petrobras would not rely on the letter if it came to asserting its strict legal rights. Mr. Justi was not authorised to give an assurance of that kind and I cannot accept either that Mr. Efromovich thought he was or that he understood him to be doing so. Mr. Justi had drafted the proposal to the board and knew that board approval was required for the payment. He also knew that the board had approved the letter setting out the basis on which the payment was to be made. Moreover, he struck me as a person who insisted on doing things by the book. In those circumstances it would be most surprising if he had felt able to give an assurance that directly undermined the board's decision. For his part Mr. Efromovich had arranged to discuss the claim with Mr. Fonseca because Mr. Padilla had been unable to make any progress with Mr. Justi. That involved taking the matter to a much higher level and if Mr. Efromovich thought that anyone was authorised to give an assurance of that kind on behalf of Petrobras, that person would surely have been Mr. Fonseca. Mr. Efromovich was also aware in a general way, if indeed Mr. Justi did not tell him, that a payment of that size required authorisation by the board, or at any rate by someone much more senior than Mr. Justi. In those circumstances I am unable to accept that he thought that Mr. Justi was authorised to override the effect of a formal document of this kind, or that he was purporting to do so, especially when he had been told that the money would not be forthcoming if Petromec did not counter-sign the letter. Finally, it is not without significance that the assurance, whatever it was, occurred in the course of a telephone conversation. There was ample opportunity for things to be said which could not reasonably be taken as anything more than comments or expressions of personal opinion. Given their knowledge of the way things had been handled under previous projects, it is not difficult to imagine Mr. Justi saying to Mr. Efromovich "They will not hold you to it", or words to that effect. That is a long way, however, from giving an assurance on behalf of Petrobras that it would not rely on its rights under the letter.

(c) Was there a failure to negotiate in good faith?

85. By clause 12.4 of the Supervision Agreement Brasoil agreed to negotiate in good faith the extra costs of upgrading the vessel in accordance with the amended specification. Ms Prevezer submitted that if as a result of the exchanges in June and July 1998 Brasoil had succeeded in limiting its liability for the work identified in the first set of variation orders to US$42,972,000, it had achieved that position only through a breach of its obligation to negotiate in good faith.

86. There was a good deal of discussion before me concerning the effect of an agreement in these terms and since the issue arises for consideration at various points in the argument it is convenient to deal with it fully now. Ms Prevezer submitted that where, as in this case, an obligation to negotiate in good faith is contained in a legally enforceable contract as an adjunct to other substantive provisions it can and should be given legal content in order to give effect to the plain intention of the parties. Mr. Hancock, relying principally on the decision of the House of Lords in ***Walford***

v Miles [1992] 2 A.C. 128, submitted that an agreement to negotiate is always devoid of legal content because it is too uncertain to be capable of enforcement.

87. The dispute between the parties in ***Walford v Miles*** arose out of negotiations for the sale of a business which were intended to lead to an agreement 'subject to contract'. At an advanced stage of the negotiations the defendants orally agreed to terminate negotiations with any other potential purchasers and not to accept any other offers if the plaintiffs provided a letter of comfort from their bankers confirming that they had finance available to complete the purchase. The plaintiffs did provide the letter and the defendants broke off negotiations with other potential purchasers, but a few days later they decided not to pursue the negotiations with the plaintiffs and sold the business to a third party. The plaintiffs brought proceedings in which they alleged, inter alia, that it was an implied term of the contract that so long as the defendants wished to sell the business they would continue to negotiate in good faith with the plaintiffs. They said that the defendants' breach of contract had deprived them of the opportunity of completing the purchase and that they had lost the difference between the price they had agreed to pay for the business and its (higher) market value.

88. Lord Ackner (with whom the other members of the House agreed) began by pointing out that there was a consistent line of authority since 1975 that an agreement to negotiate is not recognised as an enforceable contract and it is worth noticing that authorities to which he referred included two cases in which the term in question formed part of a binding contract between the parties, ***Mallozzi v Carapelli S.p.A***. [1976] 1 Lloyd's Rep. 407 and ***Nile Co. for the Export of Agricultural Crops v H. & J. M. Bennett (Commodities) Ltd*** [1986] 1 Lloyd's Rep. 555. He expressed his reasons for holding an agreement to negotiate to be unenforceable as follows at page 138C-G: *"The reason why an agreement to negotiate, like an agreement to agree, is unenforceable, is simply because it lacks the necessary certainty. The same does not apply to an agreement to use best endeavours. This uncertainty is demonstrated in the instant case by the provision which it is said has to be implied in the agreement for the determination of the negotiations. How can a court be expected to decide whether, subjectively, a proper reason existed for the termination of negotiations? The answer suggested depends upon whether the negotiations have been determined "in good faith." However the concept of a duty to carry on negotiations in good faith is inherently repugnant to the adversarial position of the parties when involved in negotiations. Each party to the negotiations is entitled to pursue his (or her) own interest, so long as he avoids making misrepresentations. To advance that interest he must be entitled, if he thinks it appropriate, to threaten to withdraw from further negotiations or to withdraw in fact, in the hope that the opposite party may seek to reopen the negotiations by offering him improved terms. Mr. Naughton, of course, accepts that the agreement upon which he relies does not contain a duty to complete the negotiations. But that still leaves the vital question - how is a vendor ever to know that he is entitled to withdraw from further negotiations? How is the court to police such an "agreement?" A duty to negotiate in good faith is as unworkable in practice as it is inherently inconsistent with the position of a negotiating party. It is here that the uncertainty lies. In my judgment, while negotiations are in existence either party is entitled to withdraw from those negotiations, at any time and for any reason. There can be thus no obligation to continue to negotiate until there is a "proper reason" to withdraw. Accordingly a bare agreement to negotiate has no legal content."*

89. This analysis is understandably directed to negotiations of the kind under consideration by their Lordships, that is, negotiations directed to the formation of contractual relations. Such negotiations can be said to be rather different from negotiations of the kind envisaged by clause 12.4 of the Supervision Agreement, since in the former case the parties are free to achieve the best outcome for themselves by any means short of misrepresentation, whereas in the latter they are restricted by the terms of the contract to ascertaining the actual amount of additional costs reasonably incurred in upgrading the vessel in accordance with the amended specification. However, while the process remains one of negotiation the fundamental objections still apply, as is emphasised by the fact that the ultimate object of negotiations is agreement between the parties. Even if it were possible to construe clause 12.4 as imposing an obligation on the parties to consider each other's arguments and supporting data dispassionately with a view to establishing common ground, that would not solve the problem because it would still be impossible to identify the content of the agreement. Irreconcilable differences might easily cause the negotiations to fail, forcing the parties to resort to litigation with nothing to show for their efforts, and it necessarily follows that if one party refused at the outset to enter into negotiations at all, it would be impossible to determine what, if anything, the other party had lost as a result because it would never be possible to know what the outcome of the negotiations would have been. The fact is that in the present case clauses 12.1 and 12.2 set out the principles which apply in determining the amount of any additional payment and clause 12.4 provides a mechanism which is intended to resolve any differences between the parties, but which is incapable of providing any remedy short of a concluded agreement.

90. Before leaving this issue I ought to mention that Ms Prevezer sought to draw support from an article by Lord Steyn in *The Law Quarterly Review* entitled *Contract Law:* ***Fulfilling the Expectations of Honest Men*** (113 L.Q.R. 433) in which he expresses the hope that English law may become more receptive to the notion of a general duty to exercise good faith in contractual relationships. In the course of that article Lord Steyn expresses surprise that the House of Lords in ***Walford v Miles*** should have held that an express agreement to negotiate in good faith is unenforceable and suggests that a party under such an obligation who negotiates in bad faith, not intending to reach agreement with the other party, should be liable for any losses caused by his actions. I can see the force of that suggestion, but even if an obligation to negotiate in good faith were recognised to that extent, a breach would not enable the innocent party to recover the benefit of the bargain (if any) to which bona fide negotiations would have led because the very existence of such a bargain (not to mention its terms) will always remain uncertain. That is exactly Petromec's difficulty in the present case.

91. Ms Prevezer's submission that Petrobras was in breach of a duty to negotiate in good faith necessarily proceeded on the assumption that the negotiations in June and July 1998 fell within clause 12.4 of the Supervision Agreement. However, I do not think that that is correct. Clause 12.1 obliged Brasoil to pay Petromec an amount equal to the reasonable *extra* costs (if any) of upgrading the vessel in accordance with the Roncador specification and clause 12.3 required Petromec to produce evidence of expenditure to support a claim that extra costs had been incurred. Clause 12.4 then provided for the claim to be negotiated. Accordingly, although the procedure is not fully spelled out, I think it is clear that clause 12 contemplates that Petromec will submit a claim identifying the amount which it says is due supported by evidence of the actual expenditure as against the expenditure required to meet the original specification. Petromec did not take that course, however, preferring instead to put forward a quote for the completion of the work covered by each variation order. Although that could lead to negotiations between the parties, they could not be negotiations of the kind contemplated by clause 12.4. In my view the process that was adopted by the parties in this case fell outside the scope of clauses 12.3 and 12.4 altogether.

92. Before leaving this issue, however, it is right that I should deal with the substance of Ms Prevezer's argument. She submitted that Petrobras acted in bad faith in taking advantage of Petromec's urgent need for funds by refusing to give any ground in the negotiations, but I do not think that fairly reflects the position. Petrobras was left to cost the work for itself on the basis of the limited information available to it. There is evidence that in some respects, for example in relation to steelwork, it carried out that exercise in a somewhat rough and ready manner, but there is no evidence that would justify a finding that its costings were made otherwise than in good faith. When the parties met to discuss the matter Mr. Fonseca explained that he could not authorise more than US$43 million on the basis of the material then available to Petrobras, which was not an unreasonable position to adopt.

7. Developments between August 1998 and May 1999

93. The delay in obtaining finance from EDC meant that Petromec was constantly under pressure in obtaining the funds needed to continue the work. On 25th August 1998 Mr. Efromovich wrote to Mr. Justi seeking a loan of US$40 million from Petrobras to enable work to continue while other sources of funds were pursued. As a result, a proposal was put to the board under which Petrobras would advance US$40 million to Petromec under security arrangements already put in place to support the earlier loan from Chase Manhattan. On 10th December 1998 the board approved a loan of US$40 million to Petromec at an interest rate of 14.25% against the security of the charter hire, but Mr. Efromovich's initial reaction was that the rate of interest was far too high. Meanwhile, Petromec had submitted the first three parts of a second set of variation orders under cover of letters dated 10th November, 23rd November and 7th December 1998. A fourth part was submitted on 23rd December 1998. Finally, on 22nd December 1998 Petromec reached agreement in principle with EDC for a loan of US$64.7 million. The funds would not become available, however, until the formal documentation had been completed and security was in place.

94. Financial difficulties affecting Davie only added to Petromec's problems. The yard could not continue to pay the workforce from week to week unless it received funds from Petromec. Petrobras considered that it was Petromec's responsibility to finance the work, as had been the case with the original project. Petromec, however, insisted that financing the work had become Petrobras's responsibility and continued to complain that it had failed to meet its obligation to cover all the additional costs attributable to the change to Roncador.

95. In January 1999 the most pressing problem was to ensure a regular flow of funds to Davie to enable work to continue on the vessel. On 14th January the board of Petrobras approved a proposal from the Engineering department to provide a bridging loan to Petromec of US$1.5 million a week up to a total of US$15 million in order to cover the yard's expenses pending the completion of the formalities in respect of the loan of US$40 million. Again, interest on this loan was payable at 14.25%.

96. The acceptance by Petromec of this funding sparked an exchange of correspondence in which the dispute about payment for the work covered by the first set of variation orders was ventilated once again. Petromec insisted that the payments of US$1.5 million a week were an advance of amounts due in respect of variation orders to which it was entitled under clause 12 of the Supervision Agreement; Petrobras insisted that they were simply instalments of a bridging loan. In a letter to Petromec of 24th February 1999 Mr. Jorge stated that the amount payable in respect of the first set of variation orders had been agreed and paid; in response Petromec reiterated that all that had been agreed was a payment on account. This repetition of the parties' positions continued well into April when agreement was reached on the terms of the US$40 million loan. It adds nothing to the dispute itself, but it is of importance in that it forms part of the background to the next stage in the development of their relationship.

8. The Deed of Payment and Indemnity and the Keepwell Agreement

97. The second set of variation orders was prepared in the same manner as the first. Petrobras was therefore left to evaluate Petromec's bid as before. In March 1999 Mr. Justi visited the shipyard to assess the progress of the works and in the meantime Mr. Jorge and his team in Quebec had been analysing the variation orders. In the report of his trip Mr. Justi recorded that the total amount put forward by Petromec for the work they covered was US$53 million and that an initial evaluation suggested that US$15 million was acceptable. He also noted that the most important factor was to establish how much Petromec had allowed for the cost of carrying out the original South Marlim project.

98. In the event the final amount acceptable to Petrobras in respect of the second set of variation orders was US$12,877,571. Mr. Justi prepared a proposal dated 13th April 1999 for submission to the board through Mr. Fonseca and Mr. Vilarinho, but a new board was appointed at about that time and the proposal was held back. There is no evidence that the figure of US$12,877,571 was the result of any discussion or agreement between the

parties, probably because by that time Mr. Efromovich had come to the conclusion that, if there were to be negotiations once the project had been completed, it did not matter too much what figure was attached to them at that stage. However, Petrobras did accept that it had not finished analysing Variation Order 13 and that the amount it had allowed for that part of the work was only provisional. Mr. Justi discussed the variation orders with Mr. Hawksley and Mr. Padilla early in May 1999, but only in relation to the timing, rather than the amount, of the payment. By that time he had already prepared a second proposal dated 27th April in substantially the same terms, this time for presentation to the board by Mr. Menezes, the new director responsible for the Engineering department. Attached to the proposal was a draft letter in similar terms to that which had been prepared on the previous occasion. That proposal went to the board on 6th and 13th May, but on each occasion a decision was deferred. It finally obtained approval on 20th May.

99. In the meantime the parties' lawyers had been drafting the documents needed to implement the agreement for the loan of US$40 million. They culminated in two related agreements, each dated 21st May 1999: the DPI between Brasoil and Petromec and a letter agreement between Maritima and Brasoil which became known as the *"Keepwell Agreement*". On the same date Petromec and Petro-Deep counter-signed a letter from Petrobras confirming their agreement that the price of the work described in the second set of variation orders was US$12,877,571. When he signed the letter on behalf of Petro-Deep Mr. Efromovich added the words *"Obs[ervation]: As per attached, it is understood that the V.O. 013 is still open and the approved value is not accepted by Petromec."*

100. The purpose of the DPI and the Keepwell Agreement was to establish the basis on which Petrobras, through Brasoil, would make funds available to Petromec. In summary, Brasoil would lend money to Petromec by making payments on its behalf direct to sub-contractors and suppliers. It would be entitled to recover the loans by setting them off against amounts due to Petromec in respect of variation orders but any amounts not previously recovered in that way would be repaid by Petromec on specified dates out of the balance of instalments of hire remaining after payments due to Chase Manhattan had been made. The Keepwell Agreement, by which Maritima undertook to take all necessary steps to cause Petromec to perform its obligations under the DPI, was intended to provide additional support for that agreement.

101. The main interest of the DPI for present purposes lies in recital (E) which provided as follows:

"WHEREAS . . . . . .

(E) Petromec and Brasoil confirm that the Change Orders, copies of which are attached as Appendix 1, are agreed and the subject matter thereof is not subject to further claims or alterations. Petromec and Brasoil acknowledge that further Change Orders may be agreed between them in the future."

Appendix 1 contained copies of the letters of 9th July 1998 and 21st May 1999 confirming the agreement of Petromec and Petro-Deep to the amounts payable in respect of the first two sets of variation orders.

102. Mr. Hancock submitted that the effect of recital (E) was to bind the parties to the figures set out in the two letters and to preclude Petromec from recovering any further amount in respect of the work covered by the first two sets of variation orders, apart from Variation Order 13. Ms Prevezer, on the other hand, argued that the recitals themselves were not of their nature binding, being intended to be nothing more than statements of fact. She sought to draw support for that submission from the speech of Lord Wright in *IRC v Raphael* [1935] A.C. 96 at pages 143-146.

103. The issue before the House in that case was whether recitals in a deed of settlement describing the settlor's intentions could control the construction of the operative clauses when those clauses were clear. Their Lordships held by a majority that they could not, but the question in the present case is rather different, namely, whether recital (E) was intended to form part of the consideration for the agreement or to form an agreed basis on which the parties entered into it. On the latter view it could give rise to an estoppel by convention. Having regard to the background to the agreement, in particular the fact that the dispute over the variation orders had been ventilated on and off during the preceding months, I think it is clear that the purpose of including this recital was to lay to rest any further dispute over the first two sets of variation orders. Contrary to Ms Prevezer's submission, I do not think that the recital or the letters in Appendix 1 can be read as allowing Petromec to obtain additional payments for the same work by reference to information that was not available at the time the variation orders were originally submitted. That would be quite contrary to the natural meaning of the words used. For reasons that I have already given I think that recital (E) correctly states the position between the parties, but even if that is wrong, it does in my view preclude Petromec from recovering any additional payments in respect of the work covered by the first two sets of variation orders if the deed is effective in accordance with its terms.

104. However, Petromec contended that Brasoil was not entitled to rely on recital (E) because Mr. Rui Dias, then head of Petrobras's Legal department, assured Mr. Efromovich that Petrobras would not use the agreement against him in order to persuade him to sign it. In order to understand this argument properly it is necessary to describe the circumstances under which the DPI came to be signed.

105. Drafts of the DPI and Keepwell Agreement were sent by Linklaters to Mr. Hawksley and Mr. Efromovich on 14th May 1999 with a request that their comments be sent as soon as possible because it was intended to put them before the board of Petrobras for approval that day. However, Mr. Efromovich was in Korea at the time and although the drafts were sent to him there by fax, his comments were not passed to Petrobras until 17th May. At that stage the recitals to the DPI ended with paragraph (D), but Mr. Efromovich asked that a recital (E) be added reading *"There are open V.O.s for adjustment between Brasoil and Petromec."*

On 17th and 18th May Mr. Hawksley and Mr. Padilla also put forward some amendments, but none of them is significant for present purposes.

106. Following discussions between Mr. Padilla and Mr. Justi on 18th May Mr. Padilla sent a fax to Linklaters confirming the changes that Petromec wished to have made in the draft and on 19th May in a fax drafted by Mr. Efromovich but sent in the name of Mr. Padilla Petromec confirmed its agreement to the draft, subject to the comments made in its fax of the previous day. However, on 19th May a new draft of the DPI was produced containing a new recital (E) which read as follows: *"Petromec and Brasoil confirm that the Change Order, a copy of which is attached as Appendix 1, is agreed and the subject matter thereof is not subject to further claims or alterations."*

107. Although there is no direct evidence that a copy of that draft was sent to Petromec, it would be surprising if it had not been and Mr. Efromovich confirmed that he had seen the recital in that form by the time he spoke to Mr. Dias. A copy was certainly sent to Mr. Dias who made various manuscript notes on it. On 20th May there was another meeting of the Petrobras board at which approval was sought and obtained for the payment of US$12.8 million in respect of the second set of variation orders. The board was also asked to approve the execution of the DPI by Brasoil as the basis for making available the loan. Surprisingly, perhaps, it has not been possible to identify definitively the form of the draft that was put before the board, but it is clear that the draft of 19th May had been further amended by the time it came to be signed on 21st May and I doubt whether any amendments (save perhaps obvious typographical errors) would have been made to the draft once it had been approved by the board. The likelihood is, therefore, that the DPI was already in its final form by the time it reached the board on 20th May.

108. One part of the draft that underwent further revision on or after 19th May was recital (E). When comparing it with the previous version Mr. Dias had noted that it required amendment so as to extend to "Change Orders" in the plural and he had also written the word "only" against it. This and other alterations in the text noted by Mr. Dias were made in the next version of the document and an additional sentence was added to this recital recognising that further variation orders might be agreed between Petromec and Brasoil in the future. Since Brasoil had no interest in including wording of that kind, I have little doubt that the addition of those words must have been instigated by someone acting for Petromec. If so, that of itself would suggest that Mr. Efromovich or Mr. Padilla must have discussed the draft with someone at Petrobras before 20th May and persuaded them to include the additional wording.

109. There was a good deal of confusion in the evidence about the circumstances surrounding the completion and signature of this document which took place against a commercial background that imposed considerable pressure on both Petrobras and Petromec to conclude an agreement. Davie was threatening to lay off the workforce at the end of that week if it did not receive an assurance that funds would be available to pay the men and if that happened work would come to a halt. Following the board's decision to approve the payment in respect of the second set of variation orders, Petrobras wrote to Davie on 20th May confirming that it would make US$5 million available the next day, which was enough to meet the wages bill for about a month. However, at that time Petrobras had not yet obtained Petromec's signature to the DPI.

110. It was common ground that at some point there was a telephone conversation between Mr. Efromovich and Mr. Dias about the DPI. Mr. Dias originally said that it had taken place on 19th May before the agreement had reached its final form, but Mr. Efromovich said that it had taken place late in the day on 21st May after the document had been presented to him for signature. It became apparent in the course of cross-examination that Mr. Dias did not have a very clear recollection of the course of events during the period 19th to 21st May. As head of the Legal department he was ultimately responsible for the drafting of the DPI, but the day to day work had been entrusted to another lawyer in the department, Ms Cristiana Rabello, and most of the negotiations with Petromec were conducted by her and Mr. Justi. In general Mr. Efromovich was a more reliable witness than Mr. Dias, but even so, I do not think that his recollection of these events is entirely reliable either.

111. Both Mr. Dias and Mr. Efromovich conceded a lot of ground under cross-examination. Mr. Dias accepted that Mr. Justi had asked him to speak to Mr. Efromovich because he was unwilling to sign the agreement which suggests that the conversation between them took place on 21st May, as Mr. Efromovich said, rather than at any earlier time. However, Mr. Efromovich accepted that the final sentence of recital (E) had been added as a result of a discussion between himself and Mr. Dias which must have occurred after the draft of 19th May had been distributed but before the final version was prepared for signature. I think this part of Mr. Efromovich's evidence is likely to be correct because it is the only plausible explanation that has been put forward for the addition of the final sentence to the recital. Although I am unable to accept Mr. Dias's evidence that he had several conversations and a meeting with Mr. Efromovich to discuss the draft, I do therefore accept that there was at least one discussion between them on the telephone about that matter. However, for the reasons mentioned above, I am unable to accept that it occurred as late as 21st May. I think it probably occurred on 19th May as Mr. Dias originally said. The question then is whether there was another discussion between them on 21st May when the document was ready for signature or whether Mr. Efromovich has misremembered the course of events.

112. Those who were dealing with the matter on behalf of Petrobras knew that the DPI would have to be approved by the board before it could be signed. That being the case, it seems to me very unlikely that they would have been willing to send it to the board until they were confident that its terms were agreed. The only other possibility is that they decided to obtain board approval for an agreement to which they knew Mr. Efromovich objected in the hope that he could be persuaded to sign it nonetheless. That strikes me as an unlikely course to take and no one suggested that is what really occurred. It is likely, therefore, that the discussion between Mr. Justi and Mr. Efromovich which

provoked the request to Mr. Dias to intervene occurred when the parties were negotiating over the draft, not at a later stage when the draft had already been approved by the board and prepared for signature. Moreover, no reason was suggested why at the very last minute Mr. Efromovich should have refused to allow Petromec to sign the agreement if he had been content with the draft as it stood following the amendment of recital (E). However, the documents suggest that he did have last minute thoughts about other matters.

113. The agreement was actually signed on behalf of Petromec by Mr. Padilla who sent a signed copy of it to Petrobras by fax at 16.39 on 21st May. Another copy was initialled, presumably to indicate his approval, by Mr. Efromovich and that is very likely to have preceded its signature by Mr. Padilla who I am sure would not have acted in a matter of that kind without the approval of Mr. Efromovich. Ms Prevezer drew my attention to the fact that two pages of the signed copy appear to have been transmitted later than the others and to an unidentified manuscript note made by someone within Petrobras to the effect that one version was not accepted in view of certain restrictions. When Mr. Efromovich initialled the draft he added some wording to clause 4.1, the indemnity clause ("Brasoil will bear <u>any and all</u> consequences of management involvement") and clause 5.3 dealing with interest ("Same interest applies [?] to Brasoil's debt to Petromec from day of execution of services"). I do not think it is a coincidence that those were the two pages of the signed version that were transmitted later and I infer that they had to be re-transmitted because Mr. Padilla made the alterations requested by Mr. Efromovich before he signed his copy and sent it to Petrobras. It is possible, therefore, that there was another conversation on 21st May between Mr. Efromovich and Mr. Dias relating to those two aspects of the agreement, but if there was, there is no reason to think that it had anything to do with recital (E).

114. However, the fact that the discussion about recital (E) took place before 21st May does not necessarily mean that Mr. Efromovich received no assurance from Mr. Dias of the kind he alleges. One could just as easily have been given during the course of their conversation on 19th May and indeed it might have arisen quite naturally in the context of a discussion about recital (E). The main difficulty I have with this part of the case is essentially the same as with the earlier assurance. Mr. Efromovich said that Mr. Dias told him that Petrobras "will not use it against you", meaning that it would not rely on its rights under the agreement to refuse further payment in respect of the first two sets of variation orders. However, even accepting, as I do, that those words or something similar to them were uttered by Mr. Dias, they could have been used in a variety of ways and there is little reliable evidence of the context in which they were spoken in this case.

115. I find it difficult to accept that Mr. Dias thought that he had authority to commit Petrobras in the way suggested by Mr. Efromovich, although he might well have been willing to offer his own opinion as to how it might respond in negotiations with Petromec at a later date. Equally, I find it difficult to accept that Mr. Efromovich himself thought that Mr. Dias had authority to give a formal commitment of that kind on behalf of Petrobras in relation to an agreement which he must have known required board approval. For these reasons I am unable to accept that Mr. Dias gave any assurance to Mr. Efromovich on behalf of Petrobras that it would not rely on the agreement or that he said anything that could reasonably have been interpreted in that way.

116. This makes it unnecessary to reach any conclusion on the scope of Mr. Dias's authority, but in deference to Ms Prevezer's submissions I shall deal with it shortly. Ms Prevezer reminded me of the well-known explanation of apparent authority given by Lord Denning M.R. in *Hely-Hutchinson v Brayhead Ltd* [1968] 1 Q.B. 549. She submitted that as head of the Legal department Mr. Dias had apparent authority to give an assurance on behalf of Petrobras, and thus on behalf of Brasoil, that Brasoil would not rely on certain of its rights under the agreement.

117. I am unable to accept that Mr. Dias had apparent authority to give such an assurance on behalf of Petrobras or Brasoil. I doubt very much whether the head of the Legal department of any large company would ordinarily enjoy that degree of authority, but in the circumstances of the present case no one with any understanding of the way in which Petrobras operated could have thought that Mr. Dias had authority to derogate from the agreement in that way. Moreover, the situation in the present case is not like that which the court had to consider in *First Energy (U.K.) Ltd v Hungarian International Bank Ltd* [1993] 2 Lloyd's Rep. 194, to which I was also referred, since it was not suggested that Mr. Dias was simply purporting to report his superiors' decision not to rely on recital (E). In these circumstances I do not think that anything said by Mr. Dias about the attitude of Petrobras or Brasoil to recital (E) was binding.

9. The Deed of Confirmation and Indemnity

118. While all this was going on the documents needed to give effect to the EDC loan and a supplementary credit facility from Chase Manhattan were being drafted. They included not one but two Deeds of Confirmation and Indemnity ("DCI") between Petromec and Petrobras dated 6th July 1999 in identical terms under which Petrobras confirmed the obligations it had assumed under the bareboat sub-charter and undertook to indemnify Petromec against certain losses and liabilities. The purpose of these deeds was to reconcile EDC's insistence on obtaining security for the loan from Petrobras with the inability of Petrobras as a matter of Brazilian law to provide a guarantee of the obligations of anyone other than its own subsidiaries. The way the parties went about achieving that was for Petrobras to execute a deed confirming directly to Petromec its obligations under the bareboat sub-charter (which was regarded as the primary source of funding to Petromec) and for Petromec to assign the benefit of that deed to EDC. In order to maintain parity of security between EDC and Chase Manhattan a second deed was executed for assignment to the bank. That was considered to be an acceptable way for Petrobras to provide security because it did not involve it in undertaking any new liabilities.

119. The DCI included the following provisions:

"WHEREAS . . . . . .

(E) pursuant to the terms of the Participation Agreement, the parties thereto have agreed that certain charter hire payments (the "Upgrade Hire") received by the Vessel Security Agent from Petrobras be paid to Petromec to facilitate the funding of its obligations under an agreement between Petro-Deep and Petromec dated 20th June 1997 (the "Upgrade Agreement");

(F) pursuant to the terms of the Upgrade Agreement, Petromec has agreed to procure the upgrade of the Vessel in accordance with the Specifications (as defined in the bareboat Sub-Charter Agreement) (the "Upgrade"); . . . . . .

(H) Petrobras, as ultimate charterer of the Vessel and beneficiary of the Upgrade, has agreed to confirm its obligations under the Relevant Documents to Petromec and to undertake to Petromec, and to indemnify Petromec on and subject to the terms of this Deed; . . . . . .

3 Confirmation, Indemnity and Covenant to Pay

3.1 Confirmation

Petrobras confirms and agrees with Petromec that the Bareboat Sub-Charter Agreement continues to be in full force and effect . . . . . .

(b) Charter Hire

Petrobras confirms its obligations to comply with the provisions of Clause 12.1 (Charter Hire) of the Bareboat Sub-Charter Agreement . . . . . .

3.2 Indemnity

(a) Covenant to Pay

In consideration of Petromec's continuing performance of its obligations under the Upgrade Agreement . . . . . Petrobras further undertakes, in consideration of Petromec's continuing performance of its obligations under the Upgrade Agreement to pay to Petromec on demand all amounts due from and losses incurred by Petromec . . . . . in respect of the Upgrade and/or Petromec's obligations under the Upgrade Agreement which have not already been satisfied directly or indirectly out of any Upgrade Hire received from time to time by Petromec.

(b) Indemnities, payments and set-off

Petrobras . . . . . in recognition of Petrobras' obligations to pay all costs of the Upgrade including, without limitation, any financing arrangements in respect thereof entered into by Petromec and notwithstanding any default by Petromec under any of the Relevant Documents and/or . . . . . the Upgrade Agreement shall on demand indemnify Petromec against any loss, cost, charge, expense, obligation or liability which Petromec or any of its assigns sustains or incurs as a consequence of:

(i) Petromec performing its obligations to Upgrade under the Upgrade Agreement which have not already been satisfied directly or indirectly out of any Upgrade Hire received from time to time by Petromec; . . . . . "

120. The DCIs were assigned to EDC and Chase Manhattan in July 1999. The deed assigned to EDC was re-assigned to Petromec on 15th August 2001. Ms Prevezer submitted that Petromec has incurred losses in connection with the upgrade of the vessel in the form of additional costs which have not been satisfied out of the Upgrade Hire and that those losses are recoverable from Petrobras under the indemnity given in clause 3.2(a).

121. When seeking to construe the DCI it is necessary to have regard to the definitions attached to many of the terms used in it. Expressions such as "Upgrade", "Upgrade Agreement" "Upgrade Hire" and "Relevant Documents" are all either defined in the deed itself or are given the same meaning as they bear in the bareboat sub-charter. The result is that on the face of it they are apt to refer only to the original project to upgrade the vessel in accordance with the specification for South Marlim, which was to be paid for entirely out of Petromec's share of the charter hire. There is no reference in the deed to the Supervision Agreement which was the source of Petromec's entitlement to recover the additional costs arising from the change to Roncador.

122. Although Petrobras did not incur any direct liability to Petromec for the payment of charter hire, the payment of that hire was the sole source of funding for the original project and its payment enabled Brasoil to fund Petro-Deep which in turn enabled Petro-Deep to fund Petromec. The additional cost of the Roncador project was to be financed by Brasoil and although everyone knew that the funds would have to be provided by Petrobras, there was no formal obligation on the part of Petrobras to make them available. Accordingly, any formal undertaking by Petrobras to pay Petromec the additional costs of carrying out the Roncador project would have involved, at least on the face of it, incurring a new liability.

123. Despite the way in which "Upgrade" and "Upgrade Agreement" are defined in the DCI, Ms Prevezer submitted that they must be construed as referring to the project as it then stood, not simply to the South Marlim project which had long since been abandoned. Her argument was that the Upgrade Agreement entered into on 20th June 1997 between Petromec and Petro-Deep continued in existence, albeit varied by the change in specification introduced by the Supervision Agreement.

124. I think Ms Prevezer was plainly right in saying that the Upgrade Agreement continued in force. The effect of the Supervision Agreement was to substitute the Roncador specification for the South Marlim specification and to impose on Brasoil a new obligation to pay the additional costs flowing from that change. Although it produced a substantial change in the nature of the work called for under the contract, the Supervision Agreement did not sweep away the entirety of the Upgrade Agreement; in particular Upgrade Hire continued to be payable to Petromec and still formed a substantial part of the consideration for the performance of the contract as varied. However, recital (E)

which identifies what is meant by the "Upgrade Agreement" for the purposes of the DCI makes no reference to the Supervision Agreement and recital (F) which defines the "Upgrade" does so by reference to the original South Marlim specification. In these circumstances I do not think it is possible to construe these terms as referring to the Roncador project. It may seem odd that the parties should have drafted the agreement in a way that suggests that the South Marlim project was continuing, but I think there are understandable reasons why that was done. Although the substitution of the Roncador specification did involve a substantial change in the work, I think Mr. Hancock was right in submitting that the drafting of the DCI reflects a desire to limit its scope to the payment of the charter hire which was providing the security for the loans. Moreover, some of the work to the vessel would have been required for the completion of the South Marlim project in any event, so undertakings by Petromec to continue performance of the original contract were not entirely otiose. In view of the way in which the terms are defined in the DCI I do not think that the indemnity given by Petrobras in clause 3.2 can be construed as extending to work required solely to comply with the Roncador specification.

10. The Global Payment approach

(a) Preliminary discussions

125. In May 1999 Mr. Hawksley met Mr. Justi in Rio de Janeiro to discuss the continued funding of the project. He also sought to demonstrate to Mr. Justi that more was due to Petromec by way of additional expenses arising from the change to the Roncador project than Petrobras had been willing to accept. In the course of their discussions Mr. Hawksley suggested that it would be very time-consuming and expensive to assess additional costs by reference to individual items of work and that it would be in the interests of both parties to approach the matter on a global basis by deducting from the actual costs incurred by Petromec an agreed amount representing the costs of the South Marlim project. This became known as the 'global payment approach'.

126. Mr. Hawksley's suggestion that the additional costs of the Roncador project should be assessed in that way was not unattractive to Petrobras. On 21st June Mr. Menezes met Mr. Efromovich in Quebec while he was visiting the vessel and as a result of their meeting negotiations began between Mr. Reis, Mr. Justi and Mr. Jorge with a view to disposing of the matter in that way. In order to achieve a settlement in that form it was necessary for the parties to reach agreement on two fundamental matters: the costs properly incurred by Petromec in carrying out the Roncador upgrade and the costs that it would have incurred in carrying out the South Marlim upgrade. The costs of the South Marlim project were difficult to assess because the detailed engineering design had not been completed when the change to Roncador occurred in the spring of 1997. Petromec had originally estimated that it would cost US$96 million, but Petrobras was sceptical of that and argued that the cost would have been much higher. In the end, however, the allowance to be made for South Marlim could only be a matter of negotiation. The costs incurred on the Roncador project, on the other hand, could easily be ascertained by reference to Petromec's books. By the end of July Petrobras had agreed to pursue the global payment approach provided Petromec was willing to open its books to its accountants.

127. Ms Prevezer submitted that at the end of June or in early July 1999 the parties entered into a binding agreement to adopt the global payment approach for calculating the additional amount to be paid to Petromec in respect of the Roncador project. She submitted that the essential elements of the method were that there should be an audit of Petromec's books to establish the costs actually incurred on the Roncador project from which was to be deducted the costs of the South Marlim project to establish the additional costs, to which was to be added a percentage for overheads, administration and profit.

128. The main foundation for this argument is what passed between Mr. Menezes and Mr. Efromovich during the meeting between them in Quebec on 21st June 1999. Mr. Efromovich said in evidence that he made it clear to Mr. Menezes that this had become a "cost plus" contract and that in his view the first two sets of variation orders were not closed. Mr. Menezes agreed that the two of them had discussed the cashflow for the project, but not whether the variation orders could be revisited. He was somewhat equivocal when asked whether their discussions had proceeded on the basis that Petromec would be paid on a "cost plus" basis, but whatever was said I do not think he can have ruled out that possibility. What concerned him more was how to identify the costs themselves, given the uncertainty over South Marlim. Mr. Efromovich said that he and Mr. Menezes had discussed the philosophy rather than the details of this new approach and agreed to pursue it. However, although the first two elements of the scheme were critical, I do not think that much, if any, attention was paid to the question of an uplift at that stage or that anything was agreed in relation to it.

129. There is a dispute between the parties about Mr. Menezes' authority to commit Petrobras to an agreement of that kind, but in my view there are much greater difficulties in the way of Ms Prevezer's submission that some kind of binding agreement was made on 21st June. In the first place, it is at least doubtful whether any agreement as such was made on that occasion at all. On 15th July Mr. Efromovich and Mr. Padilla had a meeting with Mr. Nelson and Mr. Justi to pursue the negotiations. Paragraph 3 of Petromec's minutes of the meeting state that Brasoil agreed to submit to higher approval a proposal to allow the work to be finished on the basis of payment of the costs actually incurred as found by the audit and paragraph 6 dealing with previous payments appears to acknowledge that the whole global payment arrangement still had to be approved. It is difficult to reconcile that with the existence of an agreement of the kind suggested by Ms Prevezer. Another important difficulty, however, is that at least one, if not two, of the elements required for the calculation of the amount payable to Petromec depended on further negotiation and agreement between the parties. The actual costs of the project could be ascertained without difficulty, but the cost attributable to South Marlim could not. Although each side had its own view, no doubt based

on a reasoned assessment of the nature of the work and its likely cost, all those involved recognised that it would have to be a matter of negotiation, and indeed paragraph 4 of the same minutes reflects the fact that negotiations on that question were going on at that very meeting. I have little doubt that both parties also contemplated that the amount of any uplift for administration and profit would have to be the subject of negotiation, although it might well have been possible to imply a term that a reasonable percentage be allowed if it were clear that there was agreement that an uplift should be paid. The cost of the South Marlim project could not be defined in that way, however.

130. It was the practice of the directors of Petrobras, as described by Mr. Menezes, to meet each morning in the chairman's office over a cup of coffee to discuss matters relating to the business. These meetings were informal in the sense that no formal notice was given, no agenda was circulated and no minutes were kept, but all directors who were in the offices were expected to attend and usually did so. They provided an opportunity for informal discussion of matters which might in due course appear on the agenda of a formal board meeting. Copies of two slide presentations were produced by Mr. Nelson as an exhibit to his witness statement. One appears to have been made shortly after the discussions on 15th July at which Mr. Efromovich indicated that Petromec would accept US$120 million for the cost of the South Marlim upgrade if it received an uplift of 25% for administration and profit. Both these figures are reflected in a slide headed "Proposal and Progress of Negotiation" which describes the current state of negotiations. Ms Prevezer submitted that Mr. Menezes would have wanted to keep his fellow directors informed of the negotiations with Petromec and that it was likely that Mr. Nelson had made a presentation to the board at one of its informal meetings soon after the meeting with Mr. Efromovich. I think it likely that this first set of slides was prepared for a presentation of that kind, but whether it was actually given is more doubtful since Mr. Nelson was sure that he had only made one presentation and I am satisfied that that must have taken place later. In the event, however, nothing turns on whether the directors were informed in July of the current state of negotiations because it is clear that nothing had yet been finally agreed. At most it can be said that they were content for the discussions with Petromec to continue.

131. On 28th July Mr. Nelson and Mr. Justi travelled to Quebec to assess the progress of the work. While they were there they met Mr. Reis on 31st July and confirmed that the audit would take place within a few days. I do not doubt that Mr. Nelson had sufficient authority to commission that exercise, but that does not mean that there was already in existence a binding agreement between Brasoil and Petromec that could support a claim based on the global payment approach. For the reasons I have already mentioned, I do not think there was. The audit was carried out between 6th and 12th August by a team from Petrobras. It is common ground that they were given unrestricted access to Petromec's books and, save for two matters on which they requested further information, that they were satisfied that the costs had all been reasonably and properly incurred.

132. Ms Prevezer submitted that as a result of Petromec's agreement to open its books, and a fortiori as a result of its actually giving the Petrobras audit team access to them, the parties became committed to adopting the global payment approach. However, for the reasons already given, I am unable to accept that that was the case. What the parties were doing was feeling their way towards a compromise based on the global payment approach. That required both an audit of the costs of the Roncador project to establish what they amounted to and agreement on the amount to be deducted for the South Marlim project. If an uplift was to be paid, that also had to be agreed both in principle and amount and would no doubt have been linked to the negotiations relating to the South Marlim costs. Those involved in this process naturally assumed that if it led to a consensus, a binding agreement would be made settling Petromec's claim for additional costs. Whether that would require the approval of the board of Petrobras or Brasoil is a separate matter. However, until a consensus was reached there could not be a binding agreement of any kind. Opening its books may have been a concession on the part of Petromec, but it was one that had to be made to enable the process to go ahead.

(b) Agreement on terms

133. Some weeks later Mr. Efromovich and Mr. Padilla attended a meeting with Mr. Nelson in Rio to discuss the additional amount to be paid to Petromec under the global payment approach. There was some dispute about the date on which this occurred and whether Mr. Justi was present as well. As far as the date is concerned, I think it unlikely that a meeting of that kind would have been held until Petrobras had received the auditors' report and had time to digest it. The report was dated 24th August, so it is unlikely that the meeting occurred until some days after that. Mr. Efromovich said that it took place on 17th September and his recollection is supported by, or perhaps based on, an entry in his diary showing that he had an appointment to see Mr. Nelson on that day. That also accords with Mr. Hawksley's recollection that he was told about the outcome of the discussions on 18th September and I think it likely that the meeting occurred on that date. As far as Mr. Justi's attendance is concerned, Mr. Nelson, Mr. Efromovich and Mr. Padilla all said that he was at the meeting and since he had played a central role in the project I should have expected him to have been there. However, he denied having been present at any meeting in which the costs of completing the South Marlim were agreed at US$112 million and said that he had never agreed with that figure. I do not think anything turns on whether Mr. Justi was there or not, but I think on balance that he probably was.

134. Although there were disagreements about the date of the meeting and the participants, it was common ground that agreement was reached on the amount to be allowed for the cost of the South Marlim upgrade in the sum of US$112 million. Mr. Nelson knew he could agree that figure and did not mind saying as much to Mr. Efromovich. It was also common ground that Mr. Efromovich raised the question of an uplift. He said that he asked for 25% but that Mr. Nelson had suggested he drop it altogether. His response was that he had to have something, but would settle for 10% to bring the matter to a speedy conclusion. He said that Mr. Nelson said he would do his best, but

would have to check with his superiors and did not agree to the figure there and then. Mr. Efromovich said that he believed that Mr. Nelson would not have been willing to handle the matter in that way if he did not already have authority to agree to 10%; he thought he just wanted to preserve some negotiating face. Mr. Nelson for his part accepted that he had agreed the US$112 million for South Marlim, but not in a way that would have suggested that he had authority to commit Petrobras there and then. He also accepted in cross-examination that he had expressed his personal opinion that a 10% uplift would be acceptable to reach a conclusion and had agreed to include it in the proposal that he would be making to the board, provided Mr. Carneiro and Mr. Menezes were happy with it. Mr. Efromovich confirmed that he had heard nothing further from Mr. Nelson or anyone else at Petrobras as to whether the 10% uplift had been agreed or not.

135. I have no doubt that when he left the meeting Mr. Efromovich was confident that a settlement based on the global payment approach was in his grasp on the basis of allowing US$112 million for the costs of South Marlim and a 10% uplift on the difference in costs to cover administration and profit. However, I do not think that any binding agreement had been reached at that stage. First, although Mr. Nelson said that he had expressed the view that a 10% uplift would be acceptable, Mr. Efromovich was quite clear in his evidence that he had not done so, but had simply said that he would refer back. Although I prefer Mr. Nelson's evidence on this point, I am satisfied that Mr. Efromovich was, as he said, insisting on an uplift as part of the deal. Until that was accepted, there was no agreement, even in principle. The fact that Mr. Nelson said he was willing to recommend both elements to his superiors and to the board enabled a degree of consensus to be reached, but both Mr. Efromovich and Mr. Nelson in their different ways made it clear that agreement on an uplift was not reached at the meeting.

136. Secondly, the way in which the uplift was handled supports the conclusion that Mr. Nelson did make it clear to Mr. Efromovich that his own agreement was not sufficient; whatever he agreed would form the subject of a recommendation which had to be approved by others within Petrobras. Mr. Efromovich had long experience of working with Petrobras and must have been reasonably well-informed about its methods. One can see from this case alone that it operated in a formal way and was much more rigid in its procedures than, for example, the Maritima group. Although his experience led Mr. Efromovich to be confident that any reasonable agreement he reached with Mr. Nelson would be approved, I am satisfied that he was aware that on a matter of this importance the formal approval of Petrobras was required before it became legally bound. However, having heard his evidence and that of Mr. Nelson, I am satisfied that the tenor of their discussions made it clear that that was so in this case. Some additional support for that conclusion is to be found in subsequent correspondence between the parties in which Petromec demanded payment from Brasoil based on allowing only US$96 million for the costs of the South Marlim upgrade. It is difficult to see how a letter in those terms could have been written if Mr. Efromovich had thought that a legally binding agreement, as opposed to an agreement in principle, had already been reached. His explanation that it was intended to put pressure on Petrobras to remit the funds did not strike me as very plausible.

(c) Mr. Nelson' authority

137. This makes it unnecessary to decide whether Mr. Nelson had actual or ostensible authority to make an agreement on behalf of Petrobras and Brasoil in the terms suggested by Ms Prevezer, but I think it right to express my opinion on the issue nonetheless since it formed an important part of her argument.

138. Ms Prevezer submitted that in view of the importance of the matter Mr. Menezes must have kept his fellow directors informed of the progress of negotiations with Petromec and must have obtained their approval to the course he was taking. I think that is probably right and I also accept that the directors were content for him to give Mr. Nelson authority to negotiate a figure of US$112 million for the South Marlim costs. It does not follow, however, that Mr. Nelson had authority to make a legally binding agreement with Petromec on behalf of Petrobras or Brasoil in an informal manner, or indeed at all. As an employee of Petrobras Mr. Nelson could only have such authority as was properly delegated to him by the board or one of his superiors acting within the scope of his own authority. Mr. Menezes did not have authority by virtue of his position as a director to bind the company in a matter of this kind; nor could he give such authority to Mr. Nelson. The fact that his fellow directors were content for him to pursue negotiations with Petromec and to reach an agreement in principle was not the same as giving him authority to make an agreement without reference back to the board. It simply enabled him to negotiate with confidence that the board was likely to approve a proposal to settle the matter on those terms.

139. It is quite clear from Mr. Efromovich's evidence that his previous experience with Petrobras had led him to believe that he could safely rely on any agreement of this kind that he made with one of its managers, regardless of his level of seniority. However, that simply means that in the past his confidence had been well-founded; it does not mean that the company held all its employees out as having unlimited authority to bind the company in whatever they chose to do. In the ordinary way an employee can be presumed to have the authority that a person in his position would normally have (see *Hely-Hutchinson v Brayhead Ltd* referred to earlier) and it will usually be appropriate to construe the scope of this apparent authority generously in favour of a third party who has relied on it. However, I do not think that a person in Mr. Nelson's position would normally have authority to conclude a final agreement on a matter of this kind,. Moreover, Mr. Efromovich knew that Mr. Nelson was not a director of Petrobras nor even the most senior member of the Engineering department. I do not think that he could reasonably have assumed that he had authority to bind the company in a matter of this kind, particularly in such an informal manner, without obtaining the specific authority of the board. It is not suggested that anyone else from Petrobras told Mr. Efromovich that Mr. Nelson had authority to conclude an agreement with Petromec.

(d) The board's decision

140. Before I come to the circumstances surrounding the board's consideration of the proposed settlement and the departure of the *P-36* from Canada it is necessary to refer to one matter that occurred during the course of the trial. On Monday 27th October 2003, after the present hearing had been running for twelve days and the evidence had been completed, Ms Prevezer applied to amend the particulars of claim to add an allegation of fraudulent misrepresentation against Petrobras. The application had been precipitated by the disclosure on the preceding Friday of certain documents that had been obtained by Petrobras from the files of Andersen Consulting.

141. The substance of the allegations which Petromec sought to make was that before their meeting on 7th October at which the global settlement proposal was on the agenda the directors of Petrobras, in particular Mr. Reichstul, Mr. Coutinho and Mr. Menezes, had already decided not to approve it but to instruct Andersen Consulting to carry out an investigation into claims being made in respect of work carried out on five platforms, including *P-36*, four of which were contracted to companies associated with Maritima. Despite that, it is said, Mr. Menezes had allowed Mr. Jorge and Mr. Justi to write to Petromec on 11th and 25th October in terms that suggested that the proposed settlement was under active consideration by the board and might soon be approved. If those letters had not been written, Petromec would have refused to release the vessel, the board would then have approved the terms of the proposed settlement in order to ensure that the vessel left Canada before the winter and Petromec would have been paid.

142. At the time of making this application Ms Prevezer accepted that the issues it raises could not in any event be determined as part of the current trial and since Mr. Hancock had had no real opportunity to discuss the proposed amendment with his clients, I decided to adjourn the application until after I had given judgment on the preliminary issues. However, as both parties recognised, the issues raised by the proposed amendment are closely related to many of those that arise in relation to the existence of an agreement to settle Petromec's claim on a global basis and to the existence of an estoppel based in part on the letters of 11th and 25th October. In those circumstances I consider it appropriate to limit my findings to the minimum necessary for the determination of those questions in order not to prejudice any future argument on the case raised by the proposed amendments.

143. Following his meeting with Mr. Efromovich Mr. Nelson prepared a slide presentation describing the course of the project and the current state of negotiations with Petromec. Mr. Nelson said that he gave the presentation to the directors at one of their morning meetings. It did not provoke any adverse comment, as far as he was aware, nor any request for further information. Some days later he drafted a formal proposal for Mr. Carneiro to put to Mr. Menezes for onward transmission to the board seeking approval for the agreement that had been reached with Mr. Efromovich. Mr. Menezes said that he was not entirely happy about the 10% uplift and that the chairman, Mr. Reichstul, had also expressed some doubts, but that he had nonetheless agreed to put it forward and that the proposal was considered by the board on 7th October. He said that after some discussion the board had decided to defer a decision and that the matter remained on the agenda to be considered again at a later date. Mr. Menezes said that he attended the board meeting and had spoken in favour of the proposal, but that his fellow directors had persuaded him that it was not a good one and that in the end they had all agreed that a decision should be deferred. However, the full minutes of the meeting, which were only made available to Petromec's solicitors on 20th October, appear to show that Mr. Menezes was not in fact present at the meeting and his account of what took place at it must therefore be considered unreliable. It is unnecessary to make any positive finding at this stage about what happened at the meeting and in view of the pending application to allege fraud I do not propose to do so. It is clear from the minutes, however, that for one reason or another the proposal was put back for consideration at the next meeting.

144. Ms Prevezer submitted that the board depended entirely on the staff of the Engineering department to assess the additional costs of the Roncador project and was in no position to assess the merits of the proposal for itself, but I think that puts the matter rather too high. No one was in a position to assess the costs of the South Marlim project with any precision; to do so would have required an enormous amount of work starting with the development of a detailed engineering design that had never been produced. It therefore became a matter of negotiation. The addition of an uplift in respect of profit for which, as I have held, and as some of the directors may have believed, the contract did not provide, made the matter even more one of negotiation rather than analysis. However, that is beside the point. Either Mr. Nelson had committed Petrobras in the course of his meeting with Mr. Efromovich, or he had not. If, as I have held, he had not, the fact that the board had no reliable basis for questioning the agreement does not matter.

(e) Estoppel

145. In June 1999 Petromec had entered into a contract for the vessel to be dry towed to Brazil, leaving Sept Isles, where she was due to undergo inclining tests, during October. By early October there was growing pressure on both parties to ensure that the vessel left the St Lawrence before the onset of winter caused her to be iced in. On 8th October Mr. Reis with the approval of Mr. Efromovich wrote to Mr. Jorge recording that Brasoil had asked Petromec to arrange for the vessel to be transported to Brazil for completion of the work and warning that it was only willing to comply with that request if it first received payment for the additional costs. These were calculated in the letter on the basis of allowing only US$96 million for South Marlim instead of the US$112 agreed between Mr. Efromovich and Mr. Nelson. Mr. Reis did not say in terms that the vessel would not be allowed to leave Canada if payment were not forthcoming, but I doubt that the point was lost on Petrobras.

146. On 11th October Mr. Jorge in Quebec sent a letter to Mr. Reis with the knowledge and approval of Mr. Menezes in which he said *"With regard to the amount claimed, a recently negociated [sic] proposal has been submitted to the*

PETROBRAS board which will be considered during the course of this week. The agreed amount will be paid as determined by that board meeting."

147. On 18th October Mr. Reis replied as follows:

"We have complied with your request to maintain the schedule for the departure of the P-36 to Brazil in reliance on the assurance in your letter that the recently negotiated proposal would be considered by your board during the course of last week and that the agreed amount would be paid as determined by that board.

We had every expectation that the board would instruct that the payment be made in accordance with the agreements between us. . . . . .

We will continue with the trials of the P-36 at Sept Isles but consider it appropriate that all matters are agreed between us in writing before the P-36 is loaded onto the Mighty Servant for transportation to Brazil. We trust you will be able to obtain any authority you require for this from your board this week. "

148. Shortly afterwards Mr. Efromovich spoke by telephone to Mr. Nelson who expressed concern that Petromec might prevent the vessel from leaving Canada if it did not receive payment. Apparently another employee of Petrobras, Mr. Musa, who was present with Mr. Nelson said that if he let the platform go, Petromec would be paid, but if he did not, Petrobras would sit on the money.

149. On 25th October, just a day before the vessel began loading on to the barge for the tow to Brazil, in a letter signed by Mr. Justi on his behalf Mr. Jorge responded as follows:

"The negotiated proposal was submitted to the Petrobras board last week and is being analyzed by the board. The matter will hopefully be finalized by the board in the near future . . . . . .

We will pursue the matter of payment with the Petrobras board and look forward to receiving your confirmation that matters will proceed on schedule."

150. In the event the vessel was formally handed over on 28th October and reached Rio de Janeiro on 19th November.

151. Ms Prevezer submitted that although it had approved the payment of additional costs based on the global payment approach and an allowance of US$112 for the South Marlim costs, the board of Petrobras had decided shortly before the end of September to obtain the release of the vessel without making any immediate payment and to negotiate a solution to the claim in conjunction with a number of other disputes it had with Petromec.

152. The appointment of the new board following presidential elections in Brazil had led to a reappraisal of Petrobras's relationship with the Maritima group. That appears to have been motivated, at least in part, by concerns in some quarters that their relationship had become too close. As a result some contracts between them had been cancelled and a number of disputes had already arisen as a result. Moreover, on 9th September 1999 the National Audit Court had notified Petrobras that it was conducting an investigation into alleged irregularities involving a number of projects undertaken with Maritima, including the project for the upgrading of *P-36*. These developments may have had some bearing on the board's decision to defer consideration of the proposal, but they lie at the heart of the allegations of fraud that Petromec is seeking to introduce and since it is unnecessary to make findings about them in order to decide the other issues that have arisen between the parties, it is clearly undesirable that I should do so while the application to amend is still pending.

153. Ms Prevezer submitted that in conversations with Mr. Efromovich and by the letters which I quoted earlier Petrobras had represented, or at least deliberately encouraged Petromec to believe, that agreement had been reached for an additional payment to be made in accordance with the terms agreed between Mr. Efromovich and Mr. Nelson on 17th September and that board approval was a mere formality. Petromec, she submitted, had acted on that assumption by failing to take steps to prevent the vessel leaving Canada and that therefore Petrobras was estopped from denying that a binding agreement had been made on those terms.

154. Perhaps the first point to make is that the conversations and letters that passed between the parties between 17th September and 26th October cannot be viewed in isolation; they have to be understood in the light of what was said at the meeting between Mr. Efromovich and Mr. Nelson. Since I have already found that Mr. Nelson did make it clear that the terms would have to be approved by others, it is that much more difficult to construe the letters as containing an unequivocal statement that a binding agreement had been reached or that board approval was a mere formality. It is also that much more difficult to view them as deliberately encouraging an assumption to that effect on the part of Mr. Efromovich. However, putting that to one side, I do not think that anything that was said by Petrobras either in conversations or in correspondence after 17th September amounted to an unequivocal statement that it had entered into a binding agreement with Petromec. The evidence does suggest that various people, including Mr. Musa and perhaps Mr. Reichstul, said various things to Mr. Efromovich which led him to think that the terms he had agreed with Mr. Nelson would be approved by the board, but it does not support the conclusion that anyone who had, or might reasonably have been thought to have had, authority to speak on behalf of Petrobras made a clear statement that a binding agreement had been made. Nor in my view can the letters written by Mr. Jorge and Mr. Justi in October 1999 be read in that way. Mr. Jorge in his letter of 11th October referred to a proposal rather than agreement and to the fact that the board would be considering it later that week. The final sentence, though not expressed as clearly as it might have been, could not be understood in the context of the rest of the letter as meaning that there was a binding agreement and that the board's decision was a formality. Moreover, Mr. Reis's response does not suggest that that is how Petromec understood it. The letter of 25th October is even less open to misinterpretation.

155. This may be why greater emphasis was placed on a different way of putting the case, namely, that Petrobras knew that Mr. Efromovich thought that there was a binding agreement between Petromec and Petrobras and encouraged him in that belief, in particular by the letters of 11th and 25th October. In support of the argument that that was sufficient to support an estoppel, if relied on by Petromec, Ms Prevezer drew my attention to the decisions in ***Salvation Army Trustee Co. v West Yorkshire Metropolitan County Council*** (1980) 41 P.&C.R. 179, ***Attorney-General of Hong Kong v Humphreys Estate (Queen's Gardens) Ltd*** [1987] A.C. 114 and the Australian case of ***Walton's Stores (Interstate) Ltd v Maher*** 76 A.L.R. 513.

156. ***Salvation Army Trustee Co. v West Yorkshire Metropolitan County Council*** arose out of a proposed road-widening scheme in Bradford. In order to implement the scheme the city council as the local highway authority needed to acquire land on which there was a meeting hall used by the Salvation Army. The council initiated negotiations for the payment of compensation in respect of the compulsory purchase of the land and made available a site for a new hall which was in due course constructed. As a result of a local government reorganisation the functions of the city council as highway authority were transferred to the county council which decided not to proceed with the road-widening scheme or the compulsory purchase of the original site. In the absence of a contract for the sale to the council of the original site the plaintiff relied on a proprietary estoppel to prevent the defendant from denying that an interest in the site had been transferred to it so that it was liable accordingly. The court held that the acquisition of the new site was sufficiently closely connected to the disposal of the old site to engage the principles of proprietary estoppel and that since the conduct of the city council had encouraged the plaintiff to believe that the arrangement was one from which it could not lawfully resile that was sufficient to give rise to an equitable obligation to go through with the transaction. In reaching that conclusion Woolf J. applied the principles identified in ***Crabb v Arun District Council*** [1976] Ch. 179 and ***Western Fish Products Ltd v Penwith District Council*** (1978) 38 P.&C.R. 7.

157. ***Attorney-General of Hong Kong v Humphreys Estate (Queen's Gardens) Ltd*** concerned negotiations by the government of Hong Kong for the sale of flats in a building owned by a property group in exchange for a lease over other property with a right of development. Agreement was reached 'subject to contract' and on terms that specifically stated that any agreement was subject to the execution of the necessary documents. The group permitted the government to take possession of the flats and the government granted the group a licence, revocable at any time without notice, to enter onto its property and allowed it to begin demolition in preparation for redevelopment. Some years later, no agreement having been signed, the group decided to withdraw from the negotiations and gave notice to the government terminating its licence to occupy the flats. The Privy Council held that since the group had made it clear to the government that it retained the right to resile from the agreement, the government had failed to prove that the group had created or encouraged an expectation or belief by the government that it would regard the agreement as binding and would perform it.

158. Both these cases involved what has become known as proprietary estoppel by which a person may be entitled to receive the benefit of an assurance or expectation given or created by the owner of land. It is derived from the judgment of Lord Kingsdown in ***Ramsden v Dyson*** (1866) L.R. 1 H.L. 129 and proceeds on the footing that if a person is induced to take possession of land and to incur expense on it as a result of an informal agreement with the owner, or an expectation created or encouraged by the owner, that he will be given an interest in the land, the owner will be estopped from denying an obligation to give effect to that agreement or expectation. That, of course, is not the present case, but these decisions are of some assistance to Petromec insofar as they suggest that the deliberate creation or encouragement of an expectation which induces another to act to his detriment may amount to much the same as a representation and may therefore be sufficient to support an estoppel.

159. ***Walton's Stores (Interstate) Ltd v Maher*** takes the argument a stage further. Walton's negotiated for some time with the respondents for a lease of land on which the respondents, Mr. and Mrs. Maher, were to construct a new building to Walton's requirements. A time came when the Mahers' solicitors wrote to Walton's solicitors emphasising the need to conclude an agreement within the next day or two to enable the building to be completed within the time envisaged by the parties. Walton's solicitors replied enclosing the documents for the lease and saying that although they did not then have instructions on certain amendments to an earlier draft, they would inform the Mahers' solicitors the next day if any of the amendments were not agreed. The Mahers executed the documents and sent them back to Walton's solicitors for execution and exchange. The documents were not executed by Walton's and were returned some months later with a letter saying that Walton's had decided not to proceed with the lease. In the meantime work had been continuing. The previous building on the site had been demolished and the new building was nearly half completed. The Mahers brought proceedings for a declaration that a binding agreement had come into being and for specific performance or damages in lieu. The High Court of Australia dismissed an appeal from the Court of Appeal of New South Wales upholding the decision at first instance in favour of Mr. and Mrs. Maher.

160. I am particularly grateful to Mr. Foxton for his helpful analysis of this decision. Except for Gaudron J. who accepted that the Mahers had acted on the assumption that contracts had been exchanged and decided the appeal on that basis, the members of the court all proceeded on the basis that Walton's had caused or encouraged the Mahers to assume that exchange would occur and was a mere formality. For differing reasons they held that the principles of promissory estoppel operated to prevent Walton's from denying that a contract had been created between them.

161. Although I would accept that knowingly creating or lending encouragement to an existing assumption may have the same effect as a representation and may therefore in appropriate circumstances be sufficient to support an estoppel, I am unable to accept that those features are present in this case. The 10% uplift was an integral part of the proposal made by Mr. Efromovich and was not something to which on any view of the matter Mr. Nelson had

given unqualified assent. In those circumstances I am unable to accept that the staff of the Engineering department were under the impression that Mr. Efromovich thought that agreement had been finally reached or that board approval was a mere formality, nor, in the light of the correspondence, am I able to accept that they knowingly encouraged him to think that it was.

162. In those circumstances it is unnecessary to consider what steps Petromec might have taken to delay the vessel's departure from the St. Lawrence and whether, if Petromec had been able to show that it had relied on a representation of the kind alleged, it would have been entitled as a result to recover the amount payable in accordance with the terms proposed to the board. The first of these points was not canvassed very fully either in evidence or in the parties' submissions and since it is unnecessary to do so, I prefer to make no findings at this stage. The latter point is not without difficulty because the only purpose of the estoppel is to enable Petromec to obtain payment from Brasoil in accordance with an agreement which would otherwise be unenforceable. In this respect the argument comes very close to that which was accepted by the High Court of Australia in *Walton's Stores (Interstate) Ltd v Maher*. Mr. Hancock submitted, however, that under English law a cause of action cannot be created in that way.

163. In ***Combe v Combe*** [1951] 2 K.B. 215 Lord Denning M.R. said at page 220

" In none of these cases was the defendant sued on the promise, assurance, or assertion as a cause of action in itself: he was sued for some other cause, for example, a pension or a breach of contract, and the promise, assurance or assertion only played a supplementary rôle - an important rôle, no doubt, but still a supplementary role. That is, I think, its true function. It may be part of a cause of action, but not a cause of action in itself

The principle, as I understand it, is that, where one party has, by his words or conduct, made to the other a promise or assurance which was intended to affect the legal relations between them and to be acted on accordingly, then, once the other party has taken him at his word and acted on it, the one who gave the promise or assurance cannot afterwards be allowed to revert to the previous legal relations as if no such promise or assurance had been made by him, but he must accept their legal relations subject to the qualification which he himself has so introduced, even though it is not supported in point of law by any consideration but only by his word.

Seeing that the principle never stands alone as giving a cause of action in itself, it can never do away with the necessity of consideration when that is an essential part of the cause of action. The doctrine of consideration is too firmly fixed to be overthrown by a side-wind."

164. In *Walton's Stores (Interstate) Ltd v Maher* there was no pre-existing legal relationship between the parties on which Mr. and Mrs. Maher could have obtained the relief they sought. The estoppel, therefore, necessarily created a cause of action where none previously existed and I think that Mr. Foxton was right in accepting that the decision goes beyond what has so far been accepted as being the law in this country, at any rate outside the area of proprietary estoppel. The case that is often viewed as the high water mark of a similar approach in English law is ***Pacol Ltd v Trade Lines Ltd (The 'Henrik Sif')*** [1982] 1 Lloyd's Rep. 456 in which the plaintiffs brought proceedings in respect of loss and damage to three consignments of cocoa butter carried from Nigeria to the United Kingdom under bills of lading issued by the defendants on their standard form. The bills of lading contained a demise clause by virtue of which the contract of carriage was made with the owners of the vessel. The plaintiffs pursued a claim against the defendants in the mistaken belief that they were the parties liable under the bills and the defendants' agents encouraged them in that belief. After the Hague Rules time bar had elapsed the defendants pointed out that they were not parties to the contract. Webster J. held that a reasonable man would have expected the defendants' agents acting honestly and responsibly to alert the plaintiffs to the true facts, that there was therefore a duty on them to speak and that, having failed to do so, they were estopped from denying that they were parties to the bill of lading contracts. The effect of the decision was to create by means of an estoppel rights and obligations which did not otherwise exist between the parties and it must be doubted, therefore, whether in this respect the decision (which can be supported on other grounds) is consistent with earlier authorities such as *Combe v Combe*.

165. Mr. Foxton recognised this difficulty and did not seek to persuade me that the approach adopted by the High Court of Australia is one which it was open to me to follow. He submitted, however, that in the present case Petromec could rely on an existing cause of action in the form of its right to recover additional costs under clause 12.3. The difficulty with that submission, however, is that until some agreement was reached with Petrobras Petromec's only cause of action was to recover such additional costs as could be shown to have resulted from the change from South Marlim to Roncador. The only way of avoiding the detailed comparison of costs which that would inevitably require was to reach agreement by a process such as that which had been involved in the discussions over the variation orders or that which was involved in the global payment approach. If negotiations of that kind were successful, they would lead to a binding compromise under which Petromec would be entitled to recover an agreed amount. What Petromec seeks to achieve through the mechanism of an estoppel is an agreement on the amount to be paid in satisfaction of its claim for additional costs. However, that does on my view amount to relying on the estoppel to establish a cause of action separate from that which existed under clause 12.

166. For all these reasons I am satisfied that the claim based on estoppel cannot succeed.

(f) Failure to negotiate in good faith

167. Finally, Ms Prevezer submitted that in declining to approve the terms agreed between Mr. Efromovich and Mr. Nelson Petrobras was motivated by collateral considerations. It therefore failed to act in good faith in relation to the negotiations for a solution based on a global payment approach and was in breach of its obligation under clause 12.4 of the Supervision Agreement.

168. This part of the argument is particularly closely bound up with the proposed amendment to allege fraud and I propose therefore to confine myself to one question which in my view is sufficient to determine the issue.

169. For essentially the same reasons as those which I gave in relation to the negotiations relating to the first set of variation orders, I do not think that these negotiations fell within the ambit of clause 12.4 either. The whole point of the exercise was to reach an amicable compromise which would enable the parties to avoid the detailed analysis of additional costs that was contemplated by clauses 12.3 and 12.4. In other words, these were ordinary commercial negotiations in which the parties were seeking to resolve a difference between them without resort to the strict terms of the contract. No doubt there were limits to what could properly be said and done in the course of such negotiations and these may have to be considered on another occasion. For present purposes I would only say this: there has been no suggestion that the negotiations between Mr. Efromovich and Mr. Nelson were conducted otherwise than in good faith and if, as I think, the final decision rested with the board, the fact that it decided not to accept the proposed terms is not of itself a ground of complaint.

170. There are, however, other difficulties in the way of this argument. Unless it is said that Petrobras was bound in good faith to agree to a settlement on the basis of allowing US$112 million for the costs of South Marlim and an uplift of 10%, which in my view is wholly unsustainable, it is impossible to say what the outcome would have been if Petrobras had negotiated in good faith and equally impossible, therefore, to determine what loss Petromec has suffered as a result of its failure to do so. For example, the board might have responded with an offer to settle on the basis of allowing US$112 for the costs of South Marlim, but with a 5% uplift or no uplift at all. Given the broad nature of the negotiations neither of these could be said to display a want of good faith, but if either had been accepted it would have made a significant difference to the amount paid to Petromec.

171. For these reasons I am satisfied that this way of putting the claim cannot succeed either.

11. Is Petromec entitled to interest at 14.25% on amounts due from Brasoil?

172. Ms Prevezer accepted that interest at 14.25% per annum was payable by Petromec on all amounts advanced by way of loan under the DPI. She also accepted that no provision was made for the payment of interest on sums due from Brasoil to Petromec under clause 12 of the Supervision Agreement, but she submitted that it had been agreed when the weekly advances of US$1.5 million were made in early 1999 that the same rate of interest was to apply to sums due from Brasoil to Petromec.

173. I have already summarised some of the correspondence that passed between the parties at the time these payments were first made. Before the first of the weekly payments was made and accepted on 21st January 1999 Mr. Jorge had made it clear that interest at 14.25% would be payable in accordance with the terms that had already been agreed between Petrobras and Petromec for the proposed bridging loan and it was not until 19th February that Mr. Reis wrote saying that 14.25% was an appropriate rate for funds due from Brasoil to Petromec as well as from Petromec to Brasoil. In another letter Mr. Reis said that the advance made on 22nd February was accepted on the basis that interest would be calculated at 14.25% on amounts paid early or late by Brasoil.

174. I accept that Mr. Efromovich and Mr. Reis wanted to ensure that if Petromec had to pay interest at 14.25% on money lent by Brasoil, Brasoil should pay interest at the same rate on money owed to Petromec. I also accept that Mr. Efromovich made that point forcefully on different occasions to Mr. Moraes, Mr. Quintella and Mr. Justi. However, none of that is sufficient to establish an agreement between the parties that all amounts owed by Brasoil to Petromec should carry interest at that rate. Nonetheless, Petromec will be entitled in the usual way to ask the court to award interest on any sums that it is entitled to recover from Brasoil and any such award of interest is likely to reflect commercial rates applicable during the period in which the money has been outstanding.

12. Brasoil's claim to recover money paid under the DPI

175. Brasoil is seeking to recover US$58,447,788.08 as money lent to Petromec pursuant to the DPI together with interest at the agreed rate of 14.25% per annum.

(a) The principal sum

176. Petromec agreed that the sum of US$15 million advanced by way of a bridging loan prior to the execution of the DPI was treated by the parties as having been advanced under that agreement. There was some doubt about the sum of US$12.8 million agreed to be due in respect of the second set of variation orders, but since Brasoil is not seeking to treat that as an advance, it can be put on one side. Ms Prevezer submitted that various amounts totalling about US$25 million were "*advanced*" under the DPI when it became clear to Petrobras that such amounts were, or were likely to be, due under variation orders and herein lies the kernel of the dispute between the parties. Petromec says that these payments are not to be regarded as loans but as payments made in respect of Brasoil's existing liability under the Supervision Agreement. Petrobras says that they were loans and that the amount due in respect of variations is yet to be determined.

177. The DPI contemplated that advances might be made in accordance with its terms at a time when nothing was due in respect of variation orders, but in fact Brasoil seems to have tried to ensure that payments to suppliers and sub-contractors did not outstrip what it thought could already be recovered as additional expenditure. The agreement does not contain any mechanism for operating the set-off, but in practice once Petromec's right to receive additional payment had been established Brasoil would be bound either to pay what was due (leaving the advance outstanding) or retain it in repayment.

178. The third, fourth and fifth sets of variation orders were submitted in March, May and July 1999 respectively. The third and fourth sets were still being assessed by Petrobras when the negotiations for a solution based on the global

payment approach began and after that neither of the parties appears to have been very enthusiastic to resume detailed discussions of variation orders. It may be that in due course Petromec will be able to establish that further sums are due under the Supervision Agreement, but I do not think that prevents the payments made by Brasoil from being treated as advances in the meantime. This is not, as Ms Prevezer suggested, to allow form to take precedence over substance. Until the additional amount due to Petromec in respect of any particular aspect of the work had been established there could be no ascertained debt against which Brasoil could effectively set off part of the advance as contemplated by the agreement. Accordingly, Brasoil is in my view entitled to recover sums paid to suppliers and sub-contractors pursuant to the DPI in accordance with its terms, together with interest at the agreed rate.

179. One item that calls for particular mention, however, is an amount of US$2 million that was paid by Brasoil to Dockwise as an advance on the towage fee. On 22nd April Petromec asked Petrobras to advance it US$2 million to enable it to keep the work going. It was suggested that that could be by way of an advance payment for maintenance services which were for the account of Brasoil or an advance in respect of the cost of towage which Brasoil was ultimately liable to bear. In the event Petromec invoiced Brasoil for an advance payment in respect of the cost of towage and I infer that the parties had agreed to handle the matter in that way. The money was used to fund the continuation of the work.

180. Ms Prevezer submitted that this payment fell outside the scope of the DPI and in my view she is right about that. It was clear from the outset that the payment was being sought to fund the continuation of the works, although it is fair to say that, having agreed to make a payment in the form of an advance in respect of the towage services, Brasoil could have insisted on Petromec's bearing that part of the Dockwise invoice for which it had already received payment. At the time when the advance was requested the DPI did not exist, so it could only have been brought within its terms if the parties had agreed to treat it in that way. There is no evidence that they did, however. Accordingly, although Brasoil is entitled to recover that sum from Petromec as a loan, it cannot do so under terms of the DPI and interest will be recoverable in the court's discretion.

181. I therefore find that the total amount advanced under the DPI was US$56,447,788.08.

(b) Interest

182. Clauses 4.3 and 5.3 of the DPI provided for interest to be payable at the rate of 14.25% per annum compound on sums outstanding under the agreement and at the rate of 15.25% per annum following a demand for repayment. Ms Prevezer submitted that these provisions are penal in nature and therefore unenforceable.

183. At first sight this would appear an unpromising argument in the light of Mr. Reis's letter of 19th February, but the argument turns not on the rate of interest itself but on the terms of the DPI which permit, but do not oblige, Brasoil to recover money lent under the deed by set-off against sums due to Petromec under variation orders.

184. The agreement may be onerous (though there is evidence to suggest that the rate of interest reflected commercial conditions at the time the parties entered into the DPI), but I do not think that it can be regarded as penal. In the first place, although sums advanced under the agreement were to be repaid at quarterly intervals out of instalments of hire, clause 5.2 gave Petromec the right to repay advances without penalty whenever it chose to do so. Petromec was not therefore bound to the rates of interest set out in the DPI if it could obtain funds from other sources at better rates of interest. Secondly, interest at the basic rate of 14.25% was payable under the DPI in return for borrowing money, not by way of damages for breach of contract. Although there was a default rate which came into effect following an unsatisfied demand, it was only 1% above the basic rate provided for in the agreement. There is no evidence that this increase in the rate was either unreasonable having regard to circumstances existing at the time or primarily designed to deter any failure to pay promptly on demand and I do not think that it can be regarded as penal: see *Lordsvale Finance Plc v Bank of Zambia* [1996] Q.B. 752.

185. Although I do not think that agreement or judicial determination is required before Petromec has a cause of action under clause 12 of the Supervision Agreement, the set-off provisions of the DPI were incapable of being operated until Brasoil could establish with reasonable certainty what amounts were due to Petromec in respect of additional costs. The fact that certain payments were made to suppliers or sub-contractors would not of itself enable it to know that since a comparison had to be made between the costs of the Roncador project and the corresponding cost of the South Marlim project. That may go some way towards explaining why the right of set-off under clause 2.4 was discretionary rather than mandatory. Whether it does or not, however, the structure of the agreement is clear: Brasoil was entitled to make payments to third parties on behalf of Petromec; those payments constituted a loan which was to carry an agreed rate of interest and was to be repaid at agreed intervals out of specific funds; and Petromec was entitled to prepay the advance at any time, if it wished to do so.

186. There is nothing in the agreement that can be regarded as unconscionable or that would justify refusing to enforce it. There is no forfeiture of the kind considered in ***Workers Trust & Merchant Bank Ltd v Dojap Investments Ltd*** [1993] A.C. 573 (a case of forfeiture of deposit on breach of a contract to purchase real property) nor any provision that would impose a penalty in the event of default. Petromec's real complaint is that because the set-off provisions are discretionary Brasoil is in a position to maintain the advance while at the same time failing to ascertain, or pay, amounts due under the Supervision Agreement. That might in some circumstances give rise to a claim for breach of the Supervision Agreement, but it does not lead to the conclusion that the DPI itself is penal in nature. Accordingly, Brasoil is in my view entitled to recover interest in accordance with the terms of the agreement.

13. Maritima's liability under the Keepwell Agreement

187. The Keepwell Agreement provided as follows:

> *"5. In the event that Petromec fails to pay any sum payable by it to Brasoil in accordance with the terms of the [DPI] and the receivables referring to the charter hire are not available to Brasoil, Maritima unconditionally agrees that Brasoil shall be entitled to receive that sum from Maritima within 30 days of a written demand therefor."*

188. The only questions that arise in relation to this agreement are whether the "*receivables referring to the charter hire*" were "*available*" to Brasoil at the time a demand was made on Petromec, and if they were not, whether Brasoil is nonetheless prevented from pursuing a claim against Maritima. Unfortunately, neither of these issues received a great deal of attention in the course of argument. Since the Keepwell Agreement, as its terms indicate, was negotiated at the same time as the DPI and was intended to provide additional support for Petromec's obligations under that agreement, it is appropriate to have regard to the terms of the DPI when construing it.

189. The scheme of the DPI was for advances by Brasoil to Petromec to be repaid (subject to the prior exercise of its rights of set-off) out of the balance of hire due to Petromec after allowing for the repayment of the secured lenders. The DPI did not create any security in favour of Brasoil, but by clause 2.5 Petromec agreed to take whatever steps were necessary to provide Brasoil with the benefit of the security constituted by the security documents, subject to the rights of the other secured parties. In other words, Petromec agreed to create a deferred security interest in the charter hire in favour of Brasoil, if asked to do so. In the event, however, Brasoil did not ask Petromec to provide it with security of that kind and it did not do so.

190. Hire became due under the bareboat charter quarterly. Following the loss of the vessel in March 2001 part of the sums paid by the vessel's underwriters became payable to Petromec under a complex 'waterfall' arrangement agreed between the various parties to the transaction in satisfaction of its rights to receive hire in the future. Ms Prevezer submitted that, having failed to take advantage of the opportunity to recover sums due to it from the hire payable under the bareboat charter or from the lump sum that became available to Petromec following the loss of the vessel, Brasoil could not recover from Maritima sums advanced under the DPI. Mr. Hancock, however, submitted that since the hire had not been made available to Brasoil in a way that gave it an independent right to receive it, for example by means of an assignment, no receivables were available to it within the meaning of clause 5 and that Brasoil was therefore entitled to look to Maritima for payment.

191. The Keepwell Agreement is directed solely to the position in which Petromec has failed to pay amounts due under the DPI and the charter hire is not "available" to Brasoil. In my view "available" in this context must mean something more than merely available for execution in the hands of Petromec. I think it can only refer to a situation in which Brasoil does not have independent access to the charter hire as security for the loan, as was in fact the case. Ms Prevezer's argument really amounts to saying that clause 5 is to be construed as if it included a proviso that Brasoil had asked Petromec to provide security over the hire. However, there is nothing in the agreement or the surrounding circumstances which would support that. In fact, I think that the parties' intentions emerge quite clearly: if Petromec failed to pay, Brasoil became entitled to look to Maritima for payment save to the extent that it had an independent right to receive the charter hire. It had no such right and accordingly it is entitled to recover from Maritima.

14. Claims for delay and unfinished work

192. In the present action Petrobras and Brasoil are seeking to recover damages from Petromec for delay in performing the upgrade and for the cost of completing the work which remained outstanding at the time when the vessel was handed over. This claim is based on clause 9.1.4 of the Supervision Agreement which I discussed earlier.

193. It follows from what I have already said that in my view this claim must fail. Although Petromec was under an obligation to procure the completion of the upgrade within the stipulated period, that obligation was fulfilled by entering into sub-contracts for equipment, work and materials with contractors, and on terms, approved by Brasoil. In any event, Petrobras and Brasoil are estopped from pursuing a claim of this kind against Petromec.

194. In answer to this claim Petromec also relied on clause 3 of the DCI, in particular the words *" . . . . . Petrobras further undertakes . . . . . to pay to Petromec on demand . . . . . all . . . . . losses incurred by Petromec . . . . . in respect of the Upgrade",* but for the reasons I have already given, I do not think that the upgrade to which the DCI refers is the upgrade to the Roncador specification and therefore the agreement does not assist Petromec in this respect.

195. However, if I am wrong about that, it remains open to Petromec to seek an extension of time under clause 12.2(iii) of the Supervision Agreement appropriate to reflect the additional time required to complete the revised project, save insofar as final agreement has already been reached in relation to certain parts of the work.

196. Although the pleadings also contain claims by Petrobras and Brasoil against Petro-Deep under the Supervision Agreement for damages for delay and deficiencies in the completion of the upgrade, Mr. Hancock accepted that that agreement imposes no obligation on Petro-Deep and that those claims must therefore fail. Petro-Deep's obligations to Brasoil under the bareboat charter in relation to the upgrading of the vessel were performed by entering into the Upgrade Agreement with Petromec.

197. Petrobras also seeks to recover damages from Maritima under clause 3 of the MOA. However, for the reasons given earlier I do not think that Maritima is under any liability to Petrobras under the MOA and this claim too must therefore fail. Since the MOA did not give rise to any binding obligations it is no answer for Petrobras to point to the fact that it was originally contemplated that "Leaseco" would be owned solely by Maritima, but in any event I do not think the argument is sound. In the preamble to the MOA Maritima warranted that it, or a company solely owned by it ("Leaseco"), would acquire the rights necessary to transfer the use of the vessel to Brasoil and upgrade it for that

purpose. The ownership of Petromec has not been an issue at this hearing and I am not in a position to make any findings about it. However, even if Maritima were in breach of warranty, it would not follow that it remained liable under the MOA for the performance of the upgrade. All parties to the transaction were content to proceed on the basis that Petromec would fulfil the role of "Leaseco" and the transaction documents were executed on that basis.

15. The performance bond

198. Clause 3 of the MOA provided as follows: *"MARITIMA shall be responsible for builder's risk and performance bond to be issued in the benefit of Brasoil and in terms and amounts acceptable to it. These guaranties shall survive until the upgrade is satisfactorily concluded and Certificate of Delivery and Acceptance is issued and agreed to."*

199. No performance bond was issued in favour of Brasoil and Mr. Hancock submitted that Maritima was therefore in breach of the MOA.

200. I am unable to accept that submission even on the assumption that the MOA gave rise to an enforceable contract. In the first place, I have held that the MOA was not intended to govern the parties' relationship, except in one limited respect, once the transaction documents had been signed. The fact that clause 3 of the MOA provided for the security to survive until the upgrade had been completed merely identifies the period for which it was to remain effective. It does not mean that Maritima's obligation to provide the security could not be superseded by a corresponding obligation on another party to the transaction documents. That is in fact the course the parties took. Maritima's obligation to secure the performance of the upgrade was superseded by clause 3 of the Upgrade Agreement under which Petromec was obliged to provide or procure for the benefit of Brasoil security for the performance of the upgrade in a form reasonably acceptable to Brasoil.

201. However, there are other hurdles in the way of Mr. Hancock's argument. It is clear from the terms of clause 3 itself that in order for Maritima to comply with its obligation it would first be necessary for Brasoil to inform it of the amount and terms that would be acceptable to it. There is no evidence that Brasoil ever did ask Maritima to procure a bond of any kind and to that extent it waived any need for compliance with the MOA. Accordingly Maritima could not be in breach of that obligation. Neither the terms nor the amount of the security appear to have been discussed between Petromec and Brasoil either. Given that the whole of the upgrade was completed without any request having been made for security, I think that the inevitable conclusion is that its provision was waived by Brasoil, but in any event no claim has been made against Petromec for breach of its obligation under clause 3 of the Upgrade Agreement.

16. The Preliminary issues

202. The issues to be decided at this trial were formulated in very detailed terms by reference to the list of issues prepared for the case management conference and were subsequently modified by agreement between the parties during the course of the hearing. I do not think that it is necessary or appropriate to provide a separate answer to each question since I believe that this judgment disposes adequately of them all and is best left to speak for itself. However, I can summarise my conclusions as follows:

(i) The MOA did not give rise to a binding agreement between Petrobras and Maritima and was in any event not intended to govern the parties' relationship once the documents embodying the transaction had been executed;

(ii) Under the terms of the South Marlim agreements Petromec was under no liability for delay in completing the upgrade or for incomplete or defective work once it had entered into sub-contracts with contractors and suppliers, and on terms, approved by Brasoil;

(iii) The Supervision Agreement did not impose any additional liability on Petromec for delay in completing the upgrade or for incomplete or defective work, but in any event Petrobras and Brasoil are estopped from contending that it did;

(iv) Petromec is entitled under clause 12 of the Supervision Agreement to recover the additional costs incurred by reason of the change in specification (including costs of financing, administration and general overheads), but not to any additional profit;

(v) The negotiations relating to the amount payable in respect of the first set of variation orders were not negotiations of the kind contemplated by clause 12.4 of the Supervision Agreement;

(vi) Petrobras did not fail to negotiate in good faith in relation to the first set of variation orders and was not in breach of clause 12.4 of the Supervision Agreement;

(vii) Brasoil did not agree to treat the amount it was willing to pay in respect of the first set of variation orders as a payment on account;

(viii) The letter agreement of 9th July 1998 is binding and accordingly the price agreed for the first set of variation orders is final;

(ix) The payment agreed for the second set of variation orders was final, except in relation to Variation Order No.13;

(x) Recital (E) of the DPI correctly reflected the position between the parties, but in any event it formed part of the basis on which the agreement was made and precludes Petromec from recovering additional sums in respect of the first two sets of variation orders;

(xi) Mr. Efromovich was not induced to approve the DPI by an assurance given by Mr. Dias on behalf of Petrobras that it "would not be used against Petromec";

(xii) No binding agreement was reached between Mr. Menezes and Mr. Efromovich on 21st June 1999 for the payment of additional costs by reference to a global payment approach;

(xiii) The DCI does not give Petromec a right to recover additional costs arising out of the upgrade in accordance with the Roncador specification;

(xiv) No final agreement on terms for a settlement of Petromec's claim for additional costs was reached between Mr. Efromovich and Mr. Nelson on 17th September 1999;

(xv) At the meeting on 17th September Mr. Nelson did not purport to bind Petrobras or Brasoil to any terms and did not have actual or apparent authority to do so;

(xvi) The board of Petrobras did not approve any terms of settlement with Petromec;

(xvii) Neither Petrobras nor Brasoil is estopped from denying the existence of a binding agreement to settle Petromec's claim for additional costs on the basis of a global payment approach;

(xviii) In relation to the negotiations for a settlement based on a global payment approach neither nor Brasoil was in breach of a duty to negotiate in good faith imposed by clause 12.4 of the Supervision Agreement;

(xix) Petromec has no contractual right to interest at 14.25% on any sums outstanding from Brasoil or Petrobras;

(xx) Brasoil is entitled to recover US$56,447,788.08 in respect of sums advanced under the DPI together with interest in accordance with the terms of that agreement;

(xxi) Maritima is liable to Brasoil under clause 5 of the Keepwell Agreement in respect of sums advanced to Petromec which remain unpaid;

(xxii) Neither Petromec nor Maritima is liable for delay in the completion of the work;

(xxiii) Maritima is not liable to Petrobras for failing to provide a performance bond in respect of the work.

Ms Sue Prevezer Q.C. and Mr. David Foxton (instructed by Curtis Davis Garrard) for the claimant and Part 20 defendants
Mr. Christopher Hancock Q.C. and Mr. Malcolm Jarvis (instructed by Linklaters) for the defendants and Part 20 claimants