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Joint Operating Agreements: An International Comparison From Petroleum Law

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Joint Operating Agreements ("JOAs") are often used in capital-intensive resource industries by parties who wish to restrict their exposure, particularly in limiting costs or liability. Investment prudence in these industries necessitates a mix of participants who contribute some or all of the financing, intelligence, access to market or privileged access to the project itself. Typically, standard form documents provide the terms in JOAs where the venture is one of a recurring nature.

This article examines elements of JOAs as they relate to the United Kingdom Continental Shelf ("UKCS") industry, contrasting these with American, Canadian, Australian and New Zealand petroleum law practice. After a brief history of JOAs, the paper reviews several areas of concern: control of joint operations, fiduciary duties, change of operator and production in kind. The paper also discusses the extent of a participant's interest, liabilities of operators, default clauses, abandonment, and several other issues. A final section investigates the future of JOAs, concentrating on their current problems and prospects in resource industries.

I. THE SCOPE OF JOAs

JOAs have existed at least since the first oil field was discovered by Colonel Drake in the 1860s. Widely used in the

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resources industry, a JOA typically involves two or more natural or legal persons combining property and expertise to carry out a single business enterprise in which they have a joint proprietary interest, a joint right to control and a sharing of profits and losses.[1] Conceptually, a JOA comprises the "constitution" which governs the joint venture and it is functionally akin to a partnership or limited partnership agreement or to the Memorandum and Articles of Association of a company.[2] A joint venture (or "joint adventure") is "an association of persons for the prosecution of a single venture."[3] The usual elements of a joint venture include:

1. community interest in the object of the undertaking;
2. pro-rata right to direct and govern the conduct of each other with respect thereto;
3. share to the extent of their respective percentage interest in the losses or profits;
4. close, possibly fiduciary, relationship between the parties.[4]

Many early JOAs were based on North American forms such as the American Association of Petroleum Landsmen's (AAPL) Model Form Operating Agreement and the Canadian Association of Petroleum Landsmen's (CAPL) Operating Procedure. The AAPL developed a model form JOA in the 1950s known as Form 610-1956 which subsequenty became accepted industry-wide.[5] This was revised in 1977, with the current model being 610-1982. In Canada, the CAPL devised proforma agreements in 1969, 1971, 1974 and 1981. In 1990, the latest standard form of operating procedure was produced, with one of its main objectives being a re-balancing of the needs of the different parties to the agreement.[6]

While the AAPL model formed the basis for many of the early U.K. JOAs, the forms of agreements entered into were

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[1] Maliss v. Bankers Trust Co., 717 F.2d 683 (1983).

[2] MICHAEL P. G. TAYLOR, P. P. WINSOR & SALLY M. TYNE, THE JOINT OPERATING AGREEMENT: OIL AND GAS LAW 3 (1989).

[3] Beck v. Cagle, 46 Cal. App. 2d 152, 115 P.2d 613 (1941). A useful guide to joint ventures in general is DRAFTING INTERNATIONAL JOINT VENTURE AGREEMENTS (1991).

[4] *Beck v. Cagle*, 115 P.2d at 613.

[5] *See* Marvin L. Wigley, *A.A.P.L Form 610-1977 Model Form Operating Agreement*, 24 ROCKY MTN. MIN. L. INST. 693, 697 (1978) ("The A.A.P.L. Model Form became, without question, the most widely accepted and most often used in the industry").

[6] JAMES O'BYRNE, 1990 CAPL OPERATING PROCEDURE IN OIL & GAS OPERATING AGREEMENTS: CONVENTIONAL, FRONTIER AND INTERNATIONAL (1991) (hereinafter *LESA*).

still quite diverse. In 1976, under the guidance of the U.K. Offshore Operators Association ("UKOOA"), a working group of in-house lawyers drafted a model form JOA. In the fifth round of UKCS offshore licensing in 1977, licenses were granted, conditioned in part on the licensees excluding JOAs with the state-owned British National Oil Corporation ("BNOC") in an acceptable form. BNOC reviewed the 1976 UKOOA draft and produced[7] what is now known as the "BNOC Proforma Joint Operating Agreement for Fifth Round Licences." This has significantly influenced the form of subsequent UKCS JOAs, but no standard form U.K. JOA exists which parallels that in North America. According to one analyst,

> The imposition of the 5th and 6th round proforma JOAs [by] BNOC was resented by the Oil Industry at the time. It is a testament to the skill of the draftsmen of the BNOC proformas that, over ten years later, new JOAs still bear more than a passing resemblance to the BNOC 5th round proforma.[8]

Since 1976 it has been necessary to obtain the approval of the Secretary of State to the terms of all new joint operating agreements and to alterations to ones already in existence[9] prior to commencing operations. Failure to obtain such approval makes the licence revocable without any right of appeal.[10]

JOAs typically specify that, among the parties, the relationship is one of tenants in common and not one of partnership.[11] In the U.K., such a provision is essential for tax reasons. The arrangement should also be distinguished from a mining partnership or from a unitization agreement since it is not normally intended to affect the ownership of the minerals with the rights to produce. JOAs are sometimes confused with the broader so-called "joint venture" label:

> I use the phrase "Joint Venture" not in the sense of suggesting that in this case there was anything in the way of a legal

[7] This occurred in conjunction with a leading firm of London Solicitors.

[8] Taylor et al., *supra* note 2, at 5-6.

[9] There was a lacuna in the 1966 Regulations, cured by Model Clause 39(5) of the Petroleum (Production) (Seaward Areas) Regulations 1976 (S.I. 1976/1129), which is currently model clause 41((5) of the 1988 Regulations (S.I. 1988/1213); any reference to Model Clauses is to the 1988 Regulations unless specified otherwise. Note that the Model Clauses refer to the "Minister."

[10] Model Clause 42(5) Petroleum (Production) (Seaward Areas) Regulations 1976 (S.I. 1976/1129).

[11] A. LUCAS & C. HUNT, OIL AND GAS LAW IN CANADA 165 (1990).

> partnership between the plaintiff and the defendant but merely to describe what perhaps some ordinary person might think of the relationship between the two.[12]

Therefore, a joint operation can be carried on by a JOA, joint venture, partnership, corporation or trust with different legal implications attaching respectively to ownership of the minerals and to the rights to produce them. In the U.S., JOAs do not create a separate tax entity.[13] Hence, the proprietary interests in the JOA is characterized by the law of co-tenancy. A co-tenant cannot claim part of the property to the exclusion of other co-tenants, each being liable to the other both for waste and for receiving more than each co-tenant's share.[14]

II. CONTROL OF JOINT OPERATIONS

Petroleum in situ in the U.K. is vested in the Crown pursuant to the Petroleum (Production) Act 1934,[15] empowering[16] the Secretary of State for Energy[17] to issue licenses "to search and bore for, and get, petroleum." These provisions have been extended to the U.K. territorial sea and continental shelf while similar provisions are to be found in Section 1(7) of the Continental Shelf Act 1964[18] and Section 18 of the Oil and Gas (Enterprise) Act 1982.[19] The form of licence is contractual, executed as a deed between the Secretary of State and the licensee. The licensee grants an exclusive right to search, bore for, and remove petroleum from the sea-bed and sub-soil under the relevant block. It has been further suggested this constitutes an *in rem* right. However, the licence, although contractual in form, also performs significant regulatory functions.[20]

UKCS licenses make reference to "licensee" in the singular, although this entity may include co-licensees whose obligations

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[12] Inglefield v. Macey 2 KIR 146, (1967).

[13] HOWARD R. WILLIAMS & CHARLES J. MEYERS, OIL AND GAS TERMS 490 (7th ed., 1987).

[14] Statute of Westminster (1285), Statute of 4 Ann (1705).

[15] Petroleum (Production) Act 1934, 24 & 25 Geo. 5, clause 36.

[16] *Id.* at 2

[17] Secretary of State for Trade and Industry from April 1992, folowing the elimination of the Department of Energy as a separate entity.

[18] Continental Shelf Act 1964 clause 29.

[19] Oil and Gas (Enterprise) Act 1982 clause 23.

[20] Contained in Model Clauses 14-15, 17-33, 35-36 and 40-42; the other clauses are contractual in nature; *see also* Alexander J. Black, *Comparative Licensing Aspects of Canadian & United Kingdom Petroleum Law*, 21 Tex. Int.L.J.471 (1986).

under the licence are joint and several. However, licences are silent about the bargain *inter se* of the co-licensees.[21] While the licence notionally establishes a joint tenancy, the JOA percentage interest clause[22] effectively severs a joint tenancy and imputes to each of the participants as tenants in common with an undivided interest in the licence commensurate with its percentage interest. Pursuant to Section 2(1) of the Partnership Act licensees are regarded as co-owners of the license and of any petroleum won and saved under that license.[23]

In the UKCS "won" refers to the winning of access to minerals prior to the start of the extraction process and "save" means "brought into possession under control and that, as regards the extraction of petroleum, this stage is reached either when the petroleum has passed the well-head or when it has passed through the initial separation and stabilization processes on the production platform".[24]

The Secretary of State will initiate an offshore licensing round by advertising the available block(s), the criteria for assessing applications and the terms which will be included in any license.[25] Once granted, a licence necessitates the obtaining of certain consents and approvals from the relevant government Minister at the Department of Trade and Industry, including consent to carry out development and production operations,[26] consent to any assignment of license interests.[27] Also included is approval of the terms of certain agreements between the licensees,[28] particularly including JOAs and farm-ins, prior to commencing operations.

From the first licensing round in 1964 until the fourteenth in 1992, on-going refinement of United Kingdom JOAs has been aimed the changing regulatory environment and changing perceptions of the allocation of risks and responsibilities within the JOA. For example, (although affecting the onshore, not offshore), the 1984 Petroleum (Production) (Landward Areas)

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[21] LINKLATERS & PAINES WITH CHRISTOPHER NIGHTINGALE, JOINT VENTURES (1990) (Linklaters & Paines is a leading law firm in London).

[22] DAINTITH & WILLOUGHBY, MANUAL OF UNITED KINGDOM OIL AND GAS LAW 96 (1984).

[23] *Id.* at 28.

[24] *Id.* at 441 (1977).

[25] These terms will principally be the relevant Model Clauses.

[26] Model Clause 17 of the 1988 Regulations.

[27] Model Clause 41(1).

[28] Model Clause 41(5).

Regulations[29] have implemented a new licensing system in three stages: Exploration, Appraisal and Development Licenses. This new licensing approach necessitated extension of existing forms of JOAs to cater to the additional license-related decisions to be made, and to allow for the possibility of several licenses, each deriving from the single original license, being held simultaneously, possibly with parties differing from the original licensees.

JOAs appoint one of the parties to the agreement as the operator, some of whose responsibilities include to "conduct and direct and have full control, of all operations"[30] although in practice the Operating Committee may have overall supervision and control. The degree of control by the Operating Committee over the operator represents a significant difference between U.K. and North American practice. Arising from BNOC's 1977 requirement to be able to manage its interests in every joint venture in which it was involved but with limited personnel resources, the U.K. JOA places the operator firmly under the control and direction of the Operating Committee, whereas the American model forms give the operator wider discretion.

The operator acts as representative of the consortium and coordinates its activities. The operator has the right to be reimbursed for any expenditure incurred on behalf of the operations (or, more frequently, to be funded in advance by cash calls), and it is implicit, and generally also stated explicitly in U.K. JOAs, that the operator shall neither make a profit nor a loss from activities in that capacity.[31]

Under the Model Clauses of the license, the operator must maintain records and accounts for inspection by the Department of Trade and Industry; in the U.K., JOAs will normally impose comparable obligations on the operator in favor of co-licensees. An operator must also retain the document(s) of title, provide

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[29] S.I. 1984/1832; these regulations were superseded by the Petroleum (Production) (Landward Areas) Regulations 1991 S.I. 1991/981. The latter also introduced a new "Supplementary Seismic Survey Licence", but such can be held only in conjunction with one of the three principal forms of licence.

[30] ANDREW B. DERMAN, JOINT OPERATING AGREEMENTS: WORKING MANUAL (NATURAL RESOURCES LAW SECTION, AMERICAN BAR ASSOC., MONOGRAPH No.2, 11 (1986).

[31] Martyn David, *The Pitfalls of Joint Operating Agreements* 8 OIL & GAS: LAW & TAX. REV. 180, 181 (1983).

monthly statements of production and sales, pay royalties and obtain insurance.[32]

The JOA will normally require the operator to submit various programs and attendant budgets to, and receive approval from, the operating committee for each stage of the joint operations. The operating committee may approve, alter or reject programs and budgets. Once approved the operator will conventionally be both authorized and obliged to implement the program within the limits of the budget, although the JOA will normally contain procedures governing budget overruns. The JOA will require the operator to adhere to an accounting procedure using accepted principles of accounting and obtain appropriate contract approvals and insurances.[33]

Appointment as an operator requires a skilled and experienced person who must meet industry standards. Typically, the operator must

> conduct the operations in a proper and workmanlike manner in accordance with methods and practices customarily used in prudent oil and gas field practice and with that degree of diligence and prudence reasonably and ordinarily exercised by experienced operators engaged in similar activity under similar circumstances and conditions.[34]

Similarly, the CAPL Operating Procedure states "the operator shall carry out all operations diligently in a good and workmanlike manner in accordance with good oil-field practice and in accordance with the Regulations." Hence, the standard required of the operator is in accordance with good oil-field practices[35] which is akin to the broader "reasonable person" test.

III. FIDUCIARY DUTIES

Australian commentators suggest that the operator is an agent under a typical Australian mining or petroleum joint ven-

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[32] However, other than statutorily required insurance, U.K., but not customarily U.S., practice is for each JOA party to insure its individual interests separately.

[33] Taylor et al., *supra* note 2, at 19.

[34] Taylor et al., *supra* note 2, at 10; Clarification of the traditional "good and prudent oil and gas field practice" is far from straightforward; the phrase is regarded as including compliance with all recognized guidelines and standards, whether statutory, regulatory, advisory or otherwise—e.g., the seminal standards issued by the Institute of Petroleum would be considered persuasive in the U.K..

[35] For Canadian authority on this widely recieved point, see Morgan v. Sunray Petroleum Corporation, 2 WWR 603 (1941).

ture agreement.[36] In Canada, the operator of an oil and gas property is in a fiduciary relationship with the non-operators.[37] U.S. authority suggests an operator is the agent of the parties to a JOA and therefore owes them a fiduciary duty.[38] Conversely, another U.S. commentator suggests that the overall relationship between the operator and the non-operators under the AAPL Form 610 Model Form Operating Agreement is not that of agency.[39]

When operators hold property in trust for the parties or act as their agent, they will generally be subject to fiduciary obligations.[40] An old case states:

> A "fiduciary relation" exists: (a) whenever the plaintiff entrusts to the defendant property . . . and relies on the defendant to deal with such property to the benefit of the plaintiff or for purposes authorised by him, and not otherwise . . . and (b) whenever the plaintiff entrusts to the defendant a job to be performed, for instance, negotiation of a contract on his behalf or for his benefit, and relies on the defendant to procure for the plaintiff the best terms available.[41]

Once fiduciary duty is established (defined in part by the terms of the JOA, and with respect to particular transactions),[42] it follows that an operator has specific obligations, namely:

(i) to disclose any personal interest he may have in the project;
(ii) to account for interest on monies invested;

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[36] *See generally* Michael Crommelin, Australian Joint Ventures 4 J. ENER. & NAT. RESOURCES L 65 (1986).

[37] Bank of Nova Scotia v. Société Général (Canada) & Others, 58 Alta L.R. 2d 193 (Alberta C.A.) (1988); *see also* Midcon Oil & Gas Ltd. v. New British Dominion Oil Co. 12 DLR (2d) 705 (1958); Pine Pass Oil & Gas v. Pacific Petroleums 70 DLR (2d) (1966); Great Northern Petroleums and Mines Ltd. v. Merland Exploration Ltd. 36 ALBERTA L. REV. (2 ND) 97 (1984); E. M. Bredin Q.C. Types of Relationship Arising in Oil and Gas 3 ALBERTA L. REV. 333 (1964);, J.B. Ballem, The Scope of the Fiduciary Relationship 3 ALBERTA L. REV. 349 (1964); D. A. MacWilliam, Fiduciary Relationships in Oil and Gas Ventures 8 ALBERTA L. REV. 233 (1970).

[38] Britton v. Green, 325 F.2d 355 (10th Cir. 1963); Reserve Oil Inc. v. Dickson, 711 F.2d 1951 (10th Cir. 1983).

[39] E. E. Smith, *Duties and Obligations Owed by an Operator to Non-operators, Investers and Other Interested Owners*, 32 ROCKY MT. MINERAL L. INST. (1986).

[40] BOWSTED ON AGENCY, 156 (15th ed. 1985).

[41] Reading v. R, 2 KB 232 (1949) (per Asquith LJ).

[42] Boulting v. Actat, 2 QB 606, 1 All ER 716 (1963).

(iii) to exercise the accounting procedure diligently, in accordance with general principles and with the JOA;
(iv) to maintain the utmost good faith to his co-venturers, and not use his position to manipulate benefits for himself;
(v) to protect and maintain property, and not misuse it;
(vi) not to misuse information with which he has been entrusted by virtue of his position.

The High Court of Australia has held:

> The critical feature of a fiduciary relationship is that the fiduciary partakes, or agrees to act on behalf of, or in the interests of, another person in the exercise of a power or discretion which will affect the interests of that other person in a legal or practical sense.[43]

One of the leading cases in this area is *Lac Minerals Ltd. v. International Corona Resources Ltd.*, ultimately decided in the Supreme Court of Canada.[44] Lac Minerals Ltd. was a senior mining company while International Corona Resources Ltd. was a junior. In 1980, Corona, owner of a group of mining claims, obtained course and resulting assay results considered favorable by its geologist who suggested the neighboring land owned by Mrs. Williams should be obtained by Corona. Being a junior company, Corona sought to attract investors. For this reason, a site visit was arranged with Lac Minerals, a major mining corporation, with a view towards making some sort of joint arrangement. Negotiations never reached the point of contractual relationships, but the meetings, correspondence and discussion between the parties were crucial to a determination of liability.

The visitors were shown assay results, sections, maps and a drill plan, and Lac's geologist informed them of the theory that mineralized gold zone continued to the west on the adjoining property belong to Williams. Two days later, in Toronto, Co-

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[43] Hospital Products Ltd. v. United States Surgical Corporation and others 55 ACR 417, 454 (High Ct. Australia 1984).

[44] Lac Minerals Ltd. v. International Corona Resources Ltd. 2 SCR 574, (1989), 61 DLR (4th) 14, 69 OR (2d) 287, 36 OAC 57, 44 BLR 1, 26 CPR (3d) 97; *see also* D. W. M Waters, *Lac Minerals Ltd. v. International Corona Resources Ltd.* 69 CAN. BAR. REV. 455 (1990). For recent insightful details on Canadian JOA's, see Edward Evans, *The Oil and Gas Operator as Fiduciary*, 10 J. ENER. & NAT. RESOURCES L. 172 (1992). The facts concerned a gold mine in Hemlo, approximately 150 northeast of Thunder Bay in Northern Ontario. The case affects natural resource industry practices in the handling of confidential information when visiting sites or negotiating the joint development of property.

rona mentioned that it was actively attempting to acquire the Williams property but no mention was made of confidentiality. Three days after hearing Corona's full presentation, its prospector, who had earlier made an oil offer, was told by Mrs. Williams that she had received a competing offer from Lac. Corona asked Lac to turn the property over and begin proceedings, but Lac continued to proceed on its own to develop what turned out to be the biggest gold mine in Canada.

The trial court found for Corona on the basis of breach of confidence and breach of fiduciary relationship. It was found that a a matter of fact that some of the information Lac obtained from Corona was information Corona disseminated to the public in order to obtain financial support was used by Lac to further its own interests. The court also held that existing mining industry practice, concerning this type of information, suggested that a party who received such information would not use it to the detriment of the confiding person or company. The information divulged by Lac's central witness was not preferred to the credibility of Corona's witnesses, although it effectively undermined Lac's appeal in the Ontario Court of Appeal and later in the Supreme Court of Canada.

The trial court[45] found Lac was a constructive trustee and ordered that it hand over the mine to Corona, imposing a lien upon the mine to secure monetary reimbursement to Lac for the cost of purchase of, and subsequent improvements to, the disputed property. The Ontario Court of Appeal[46] upheld both the liability findings of the trial judge and the remedy imposed.

The Supreme Court of Canada upheld the trial judgement, albeit on somewhat different grounds. The Court split, with the majority holding that no fiduciary relationship arose between the parties but with the Court finding Lac liable for breach of a duty of confidence. Concerning the scope of a fiduciary duty, Justice Sopinka, for the majority, concluded the key factor was the vulnerability or dependency of the beneficiary on the fiduciary. The majority disagreed both with the trial judge and the Court of Appeal and found no fiduciary relationship existed:

> We agree that the law of fiduciary relationships does not ordinarily apply to parties who are involved in arm's length

[45] 25 DLR (4TH) 504, 53 OR (2nd) 737 (Ont. H. C. 1986)

[46] 44 DLR (4th) 582, 62 OR (2nd) 1 (Ont. C. A. 1987) (five judges sitting).

> commercial transactions. Nevertheless, it appears clear that the law of fiduciary relationships does apply in certain circumstances to persons dealing at arms length in commercial transactions.[47]

Accordingly, it was a question of fact in each case whether the relationship of the parties is such as to create a fiduciary relationship. The circumstances which give rise to such a relationship have not been fully defined nor are they limited by any permanent restriction.

The court in *Lac* identified three elements that must be established to impose liability for breach of a duty of confidence:

> (i) that the information conveyed was confidential; and
> (ii) that it was communicated in circumstances where the recipient realizes that such information is confidential and that a duty of confidence accordingly arises; and
> (iii) that the recipient, who should not employ the information to the detriment of the confider, actually misuses it.

"A reasonable person" test was applied following *Coco v. A.N. Clark (Engineers) Ltd*,[48] where Justice Megarry explained that when commercial information of a confidential nature is disclosed by one party to another in circumstances that would lead a reasonable business person to appreciate that the information is confidential and to expect the recipient would respect that confidence, the confidant is precluded from using the information for its own benefit without the consent of the confider. Hence the "reasonable person" test considers whether a reasonable person standing in the shoes of a recipient would realize the information was given in confidence.

IV. CHANGE OF OPERATOR

Since JOAs may survive for a substantial term of years, a mechanism is often included for resignation or removal of the operator. Resignation typically requires 180 days notice, although usually the operator may not resign in certain express circumstances (as before completion of a specified task).[49] The JOA usually itemizes circumstances under which the operating

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[47] *Id.* at 635-636.
[48] Coco v. A.N. Clark (Engineers) Ltd, RPC 41 (Ch.D.) (1969).
[49] For example, see the the Working Obligations of the (U.K.) Licence.

committee may remove the operator, and some U.K. JOAs will allow the operating committee (generally excluding the operator and its affiliates from voting), after a specified period of notice, to remove an operator without showing cause.

The CAPL Operating Procedure allows replacement of the operator in the event of:

> (i) insolvency or bankruptcy;[50] or
> (ii) assignment by the operator of its powers and responsibilities; or
> (iii) the operator ceasing to hold a 10% interest; or
> (iv) default by the operator as to his duties under the agreement and failure to rectify same.[51]

A contentious "Challenge of Operator" clause is set out in the CAPL Operating Procedure, which takes effect in either of two situations:

> (i) another joint venturer can offer to conduct the operation upon "more favourable terms and conditions" following which, if operator is not prepared to meet the challenge, (s)he must be replaced; or
> (ii) after two years as operator, (s)he can propose to the other parties new terms and conditions for his operatorship; a party refusing to accept the proposal must offer to conduct the operations on other terms and conditions and such a counter proposal is treated as a challenge; however, neither provision is usually found in U.K. JOAs.[52]

V. PRODUCTION IN KIND

Typically, JOAs grant participants the right (and, in the U.K., the obligation) to take production in kind and separately dispose of their percentage share. This effectively gives each joint venturer a separate interest rather than the joint one under the license, and this is essential for U.K. tax purposes. One advantage is that the interest can be used as security for borrowing, and the provision is frequently found in U.K. JOAs for this

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[50] Tri-Star Resources Ltd. v. J.C. International Petroleum Ltd et al. 2 W.W.R. 141 (Alberta Ct. Queen's Bench 1987).

[51] *1990 CAPL Operating Procedure* Cl.202. Clauses similar to this provision will normally be found in U.K. JOA'S.

[52] One of the authors has never seen such provisions in practice in 14 years in the UKCS industry.

reason. For U.S. companies, this clause is extremely important because it helps avoid anti-trust issues by highlighting the fact joint marketing is not involved and helps in the taxation field.[53]

"Underlift" occurs where a party fails to take all entitlement to petroleum related to one's percentage interest. Whether the party will later have the right to make up the underlift is the subject of mixed practice. For example, the BNOC proforma (which most recent UKCS JOAs follow) provides that where this occurs, such portion will remain in the ground and will accrue for the benefit of all the parties whenever it is later lifted. There is, arguably, an element of penalty in this provision. This element is not accidental, since the concept relates to the complexity of lifting arrangements, particularly from the larger terminals, and the disruption to the process resulting from underlift.

The CAPL Operating Procedure 1990[54] permits a party to take its proportionate share of production in kind and separately dispose of it and further states[55] that wherever a joint operator fails to take entitlement in kind, the operator shall have the authority to sell that party's share. Some Canadian operators take the position they will not exercise that authority and would leave the joint operator's reserves in the ground. But this is not necessarily a proper interpretation of the clause. When oil and gas are produced, for example, interest in the resources is owned by the parties in their proportionate shares and it is not possible to identify any one molecule of oil or gas as belonging to one party and not to another.[56] Thus ownership of oil and gas does not arise until it has been produced.[57]

VI. EXTENT OF A PARTICIPANT'S INTEREST

Like other JOA rights and liabilities, entitlement to production in kind or proportionate revenues depends upon the classi-

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[53] *See generally* LESA *supra* note 6, at 1-36.

[54] CAPL Clause 601 provides that each party "has the right" to take in kind. Clause 602 provides that whenever a Joint Operator fails to take in kind, the Operator "shall have the authority" to sell that Joint-Operator's share. This authority is "revocable by that Joint-Operator at will," yet effectively, if the Joint-Operator does not have a buyer for that production then it is not possible for that authority to be revoked. "Whenever production occurs, each Joint-Operator's share is also produced, and it must be sold or otherwise disposed of in some manner." *Id.* at 4-5.

[55] *Id.* at clause 602.

[56] *LESA*, *supra* note 6, at 1-36.

[57] The U.K. position is that title passes from the Crown to the licensee effectively upon its being produced at the wellhead.

fication of a participant's interest. According to one interpretation, an operator has authority to take all production in kind and make arrangements for its disposal.[58] As part of its marketing efforts, the operator became involved in the promotion of a fertilizer company which would use the gas, and acquired a block of shares in the company. The co-venturers claimed the operator held a proportion of the fertilizer company's shares in trust. The Supreme Court of Canada rejected this claim however, on the ground the defendant's profit in the shares arose only in its capacity as a promoter, and not in its capacity as a co-owner of the gas field.

In formulating its opinion, the Supreme Court of Canada created a working interest/carried interest dichotomy,[59] a distinction also recognized in the U.S.:

> As used in the oil industry, the holder of the carried interest of a working interest has no personal obligation for operating costs while the co-owners who advance such costs are entitled to reimbursements themselves first from future production. . . . As the term was used here, it meant that the co-owners who advanced expenses were entitled to reimburse themselves first from the profits of the venture for equal distribution to all shareholders was made.[60]

VII. AUTHORIZATION FOR EXPENDITURE ("AFE")

The AFE relates to the general programs and budgets of the JOA but is more detailed, generally covering one discrete portion of the operations. Use of AFEs tightens control over the operator's fiscal discretion,[61] allowing greater involvement for non-

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[58] Midcon Oil & Gas Co. v. New Br. Dom. Oil Co. SCR 314, 12 DLR (2d) 705 (1958), *aff'd* 21 WWR 228, 8 DLR (2d) 369, *affirming* 19 WWR 317 (Alberta).

[59] *Carried Interest*: A fractional interest in Oil and Gas Property, usually a lease, the holder of which has no personal obligation operating costs which are to be paid by owner or owners of the remaining fraction, who reimburse themselves therefore out of production, if any. The person advancing the cost is the carrying party and the other is the carried party. Three general types of interest recognised: the Abercromby - type carried interest, the Herndon type carried interest, and the Manhattan-type carried interest. WILLIAMS & MYERS, MANUAL OF OIL & GAS TERMS, (7th ed. 1987).

[60] Byrd v. Smyth, 590 S.W. 2d 772, 775, 64 O.&G.R. 530 535 (Tex. Civ. App. 1979) (citations omitted).

[61] Monashee Petroleums Ltd v. Pan Canada Resources Ltd, 70 AR 277.(1986). The content of an AFE was described by Justice Egbert: "An AFE should contain the drilling commencement date, the location of the proposed well and the depth thereof. The very nature of the words authorisation for expenditure, would require that the estimated cost drilling, including completion costs also be included." *Id.*

operators who might otherwise be treated as investors rather than participants. The UKCS norm is for AFEs to require operating committee approval prior to the operator making any commitment, while the North American approach is generally that AFEs are provided to non-operators more by way of information and do not require prior approval. Some JOAs provide for approval of an AFE unless the operating committee votes against it within a specified time limit, but the practice of deemed approvals is considered dubious by most UKCS practitioners.

In practice some operators will seek to minimize the number of AFEs required by including as much work as possible within a single AFE. This tendency should be firmly resisted by non-operators, since it works against their interests by diluting the primary purpose of AFEs. Namely it allows overruns on one section of the work to be offset against underruns elsewhere. Hence, an AFE compartmentalizes and controls JOA-related expenditure.

To illustrate this point, suppose a drilling AFE identifies well(s), geological formation and estimated depth, estimated costs of drilling and complétion, etc. On approval (where appropriate or necessary), it commits a party to its proportionate share of the necessary drilling and completion costs, unless the parties mutually agree to terminate or vary drilling and completion objectives. In *Renaissance Resources Ltd v. Metalore Resources Ltd*[62] the Alberta Court of Appeal found that

> [t]he AFE is a written manifestation of consent to participate in an undertaking. Once consent is given, the joint operator becomes liable for its share of the total costs of that undertaking.[63]

In *Metalore*, Justice Kidd applied the rule of law developed in *M&T Inc. v. Fuel Resources Development Co.*,[64] where Justice Kane had determined a joint operator of a well could not go

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[62] Renaissance Resources Ltd. v. Metalore Resources Ltd. 4 WWR 430, 31 Alta. L.R. (2d) 226 (1984), *aff'd* 4 WWR 673, 38 Alta. L.R. (2d) 133 (C.A.) (Alta. 1985).

[63] *Id.* at 443 (per Kidd J).("I find that Metalore agreed to pay its share (30%) of the total costs of the test well to casing point and abandonment. It is of some interest to note that the 1981 CAPL operating procedure requires a supplementary AFE when costs incurred in a single operations are in excess of the capital AFE amount by 10% . . . no such provision exists in the 1974 CAPL operating procedure").

[64] 518 F.Supp. 285 (D. Colo. 1981).

"non-consent" at the time the cost estimate in the AFE was surpassed and stated[65] that:

> execution of the AFE by the non-operating owners of working interests in the underlying leaseholds is a written manifestation of their consent to participate in the well. It is axiomatic that drilling costs cannot be estimated with certainty and that an AFE is at best a good faith estimate. AFE's are usually exceeded, often by very substantial amounts.[66]

In Canada an operator customarily submits a revised informational AFE[67] if costs exceed 10% of the original AFE. This does not occur in the U.K. where JOA provisions are much stricter. But in the absence of gross negligence or willful neglect, a non-operator is not likely to prevail in a suit to challenge the reasonableness of costs in excess of an AFE.

One solution to cost overruns is to provide for automatic non-consent by each operator on reaching, for example, 125% of the original AFE. All costs would then be paid by the operator who may then be afforded a right of indemnity for the extra costs (with interest) before the non-consenting parties execute back-in rights. The exact point at which the overrun is reached is not critical because the non-consent is automatic. This places a heavy burden on the operator to estimate the costs precisely but it allows cost-to-date computations to be made with the benefit of hindsight.[68]

VIII. SOLE RISK AND CONSENT

Joint ventures are seldom an association of equals.[69] Since diverging opinions can arise among the participants, the operating committee passmark will be crucial and provisions are

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[65] *Id.* at 289-90

[66] Where this may be the norm in Canada, it is certainly not so in the U.K., most JOAs contain strict provisions preventing the operator from making commitments that will take the total committed over that of the approved AFE without reversion to the Operating Committee for additional approvals. *Id.*

[67] Art.11.12 1974 COPAS or Art.11.15 of 1984 COPAS give grounds for challenge of an AFE if excessive costs were not "necessary or Proper" or that the costs were not "reasonable and necessary".

[68] J. David Heaney, *JOA, AFE and COPAS—What They Fail to Provide*, 29 ROCKY MTN. MIN. L. INST., §§7.43-7.83, 175 (1983). Such a solution is not known in the U.K. in the authors' experience.

[69] Taylor et al., *supra* note 2, at 33.

invariably incorporated in the JOA to alleviate such problems. These provisions can include "sole risk" or "non-consent" clauses and will be based on the underlying principle of non-participation in an operation by at least one member of the group. The difference in applicability between the two clauses rests on the level of support a proposal obtains at the Operating Committee stage.

A project will be "sole risk" when it was proposed to the Operating Committee but failed to reach the passmark needed in order for it to become a joint operation, and where less than all the parties elect to proceed. A project will be "non-consent" when it did receive Operating Committee approval but a party exercises its JOA-given (if applicable) right not to participate, thus shielding itself from both the costs and risks involved. The latter clause is less common and is not included in the BNOC proforma.

Sole risk operations accordingly allow one or more (but not all) of the joint venturers to carry out an operation bearing all the costs, concurrently being entitled to all the petroleum produced from that operation. The parties which opted out will, in principle, not be entitled to the commercial benefits of such operations. The JOA will normally include provisions allowing them to back-in later, although usually on payment of a large (as much as 15 times the backer-in's share of costs) premium. Contractual complications arise in the event the operator is not a sole risk party, and in such circumstances U.K. JOAs generally provide for:

(i) the operator to opt out of acting as such; and/or
(ii) the sole risk parties to request the operator to stand aside.

Conversely, the AAPL model form provides for an initial well which will have to be commenced by a certain date with unanimous participation. Thereafter, should any party wish to drill any other well on the "contract area," it will be obliged to give notice to the other participants of the proposed operation. Usually the latter will have 30 days within which to notify the first party whether or not they wish to participate. The AAPL model form envisages that the operator will carry out the work for the consenting parties. The obligations created proscribe the rights of co-tenants who drill on jointly owned property without the benefit of a JOA. Each co-tenant can enter the land and drill without the consent of other co-tenants, who cannot deny their

right to enter the land. Similar provisions are to be found in the CAPL Operating Procedure, which allow a party to carry out an "independent operation" by giving notice to the other parties.

IX. LIABILITIES OF OPERATORS

A. *Liabilities to Third Parties*

The question of operator liabilities in relationships with third parties remains one of the most complex issues in JOAs. In English law, this stems principally from the interface with the law of agency. For example, the operator will normally be the person who initiates transactions with third party contractors and suppliers to insure that day to day operations are carried out. The relationship between the operator and those third parties is largely dictated whether by the operator's status is as agent or as principal. This question of status is fundamental to determining liability.

The answer to the question is to be found in the general law of agency, rather than in any peculiarity of the JOA. Generally speaking the operator will be regarded as an agent of the JOA. For the operator's status to be that of principal rather than agent will necessitate contracting as such without disclosing the existence of the joint venture or of co-venturers. General principles of contract apply as an important distinction is drawn between a disclosed principal and an undisclosed principal whose existence is not made known by the agent to the third party. The latter is contracting with the agent with the understanding the agent is and independent party, namely a principal in his own right. Although in limited cases, the common law permits an undisclosed principal to acquire rights and be subjected to liabilities of a contract made by an agent, in most circumstances this will not be so. In the petroleum industry, this situation should not arise—thus, express or ostensible, agency law invariably answers the question.

The result is the other JOA parties can sue and be sued on the contract since the doctrine of privity of contract will not be strictly enforced. In a practical sense, it is not relevant whether the operator escapes personal civil liability; because of the nature of the JOA, the operator will still be held liable to the extent of this respective share under the agreement.

In cases other than those imposing civil liability, the operator will usually be deemed to be a principal since the operator would

normally be thought of as an independent contractor. The question of non-operators' liabilities to third parties in such circumstances can be expected, at least in English law, to turn on the extent to which the act or omission giving rise to the liability has been authorized or subsequently ratified. In circumstances other than subsequent ratification, the operator will be liable to a third party on a contract but will have recourse against the non-operators for their respective share under the agreement. The BNOC proforma (and probably all current U.K. JOAs) provides that each participant indemnifies the others to the extent of their individual percentage interest share of any claim or from liability to any third party arising from joint operations.

An underlying principle of the law of damages is that a plaintiff will only be able to recover what he or she has lost (i.e., damages are compensatory). In the JOA situation, the losses of non-operators could not be taken into consideration,[70] except to the extent that (in English law) non-operators who pay more than their proportionate share of any liability have a right to reimbursement from their co-venturers.[71] Privity will prevent non-operators from suing on the contract itself.

To circumvent this difficulty, the JOA imposes an obligation on the operator to use his best endeavors to include provisions in contracts to the effect that the operator is contracting as principal but nevertheless can recover losses of non-operators while at the same time precluding any action by the third party in contract/delict/tort against them.[72] In such cases, third party creditor rights against non-operators are limited.[73] Recent U.K. experience suggests this position fluctuates with market forces, with contractors and suppliers accepting such a limitation in a recessionary period while rejecting it when the market has turned their way.

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[70] *Woodar Investment Development v. Wimpey Construction*, 1 WLR 277, 300 (1980) where Lord Keith expressed that it was time for a review of the inconvenient rule that precludes a *jus quaesitum tertio* in English law.

[71] Civil Liability (Contributions) Act 1978.

[72] This solution is considered uneven and arguably unfair by some UKCS operators, but is conventionally insisted upon by non-operators.

[73] For a recent Alberta case, see Panamerica de Bienes y Servicos, SA v. Northern Badger Oil and Gas Ltd., AR 575 (Alberta Ct. App. 1991) which considered whether the cost of abandoning the wells should be ordered by the Energy Resources Conservation Board to be paid out of the funds held by the receiver for secured creditors or out of funds payable to the trustee in bankruptcy.

A second way to avoid the conflict over damages is for the operator to transact as disclosed agent (where following general principles, contractual liability does not usually arise) and include a provision that the operator shall be liable on the contract and the non-operators will not. The validity of such clauses is not entirely clear since they have so far never been the subject of judicial interpretation.

B. Liability to Non-operators

Another question concerns the extent the operator should be liable to the non-operators, particularly as a consequence of normally being precluded by the JOA from making any profit as operator. This practice precludes any "financial cushion" against the cost of mistakes. Despite this general principle, it is clear that in certain circumstances, the courts will uphold provisions in JOAs making the operator personally liable. For example the AAPL model form provides[74] that "the Operator is exonerated from all losses sustained or liabilities incurred except those losses which may result from gross negligence and willful misconduct." Likewise, the position created by the BNOC 5th round proforma is that, in general, the operator will only be liable for loss which results from "willful misconduct."

"Willful misconduct" is conventionally defined as an "intentional and conscious, or reckless disregard" of any provision of the JOA or of a program of operations under the JOA "not justifiable by any circumstances, but shall not include any error of judgment or mistake made by any director, employee, agent or contractor of the operator in the exercise, in good faith, of any operation, authority or discussion conferred upon the Operator."[75] The BNOC proforma ensures the operator is liable only for "willful misconduct" or negligent failure to obtain insurance.

However, willful misconduct is a defined term in the proforma, thus removing much of the subjectivity from disputes. On the other hand, "gross negligence" includes the "failure to take even the slightest care," and this term was used in the U.K. before the BNOC proforma was introduced. But, negligence is an "on-off" switch that cannot be categorized into degrees since

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[74] At Article V.

[75] Taylor et al., *supra* note 2, at 11; *see also* BNOC proforma clause 6.2.3.

any adjective placed before the word makes no difference with respect to liability.[76]

C. Environmental Liability

Development of environmental law in the U.K. in relation to JOAs is in its infancy, since the key legislation[77] is only now coming into force by gradual increments. Its initial focus is on industrial production processes such as waste. Accordingly, U.K. model JOAs, both offshore and onshore, have not yet been adapted to the new régime.

Arguably, the question concerning potential liability for the operator (acting as agent or principal) is of less significance in this context. Practical reality dictates that the operator is in daily control of operations and that the non-operators' state of knowledge and degree of control be inevitably limited. The extent of such knowledge and control will be crucial to the determination of liability. For example, where a joint venture ships its oil production from an onshore field to a remote terminal by road tanker, the detailed logistical supervision of the tankers will be at the site management level, not at the level of the joint venture operating committee. Thus, liabilities arising in this context will be those of the operator as principal, not those of the joint venture through an operator's agency.

This conclusion is supported in *Regina v Bata Industries Ltd*,[78] a recent Ontario decision concerning pollution of soil and groundwater by the local subsidiary of an international group. Three individuals were charged with pollution offenses in conjunction with the company: the Chairman (who was also CEO of the parent company), the President of the company, and the on-site Director/Manager. The Court considered the specific role of each individual in relation to the company's operations. The chairman was acquitted on the defense of due diligence on the basis that responsibilities covered more than 80 subsidiaries world-

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[76] Martyn David, *supra* note 31, at 181.

[77] Environmental Protection Act 1990

[78] Queen v. Bata Industries Limited Quicklaw, Dominion Report Service, 92-00049 (Ont. Ct. Justice, 1992) (concerning offences (storage of leaking and foaming waste drums) contrary to the Environmental Protection Act and Ontario Water Resources Act, RSO 1980, c.361 §§ 16, 16(1), 16(2), 75(1)). The Court found no proper system in place to prevent waste barrel disintegration and leakage. The Directors and managers who had personal knowledge of the corporation's waste problem and who had worked closely with the particular location were found liable as directors.

wide, that the chair visited each perhaps twice a year and that the chair appointed experienced local staff to manage local operations. The president was convicted on the basis knowldege of the problem, taking no steps taken to remedy it, and having an obligation to ensure not only that the on-site manager was given appropriate instructions, but also to ensure that these were carried out. Hence the president failed the due diligence test. The on-site Director/Manager was convicted, whose defense resting on alleged reliance of the environmental manager.

In its judgment, the court placed considerable emphasis on the existence of internal reporting systems, documentary evidence of due diligence and environmental reporting to the Board. Accordingly, the principles of *Bata* can be applied to the JOA if the Operating Committee is in the same position as the Chairman/CEO which meets monthly or quarterly to review joint venture operations. Non-operators liabilities in this area are likely to be limited.[79]

X. THE DEFAULT CLAUSE

Default clauses contemplate the possibility that a non-operator may not be sufficiently funded to meet joint venture commitments. Accordingly, the default clause may be one of the most vital of the JOA clauses. Potentially serious consequences for the progress of the joint operations can arise where one of the non-operators fails to meet its share of a cash call made under the JOA.

Early JOAs often proceeded on the basis that the non-defaulters would have a lien over the defaulter's share of joint property and joint petroleum as produced. Problems such as this arose insofar as such a lien was deemed to constitute a registrable charge and, if not registered within 21 days in accordance with the U.K. Companies Act (1948 through 1985), it could not be enforced against a liquidator or other creditors of a defaulter. Also, as the lien attached principally to production, it would be of little use where production had not yet commenced.

The modern form of JOA normally includes a "forfeiture for default clause." Such a clause does not constitute a registra-

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[79] While *Bata* is Canadian, its principles should be applicable in the U.K.; however the more leonine U.S. statutory and regulatory regime may lead to a different conclusion.

ble charge. The justification for this somewhat radical clause was that nothing short of outright forfeiture of a defaulter's interest would provide sufficient protection for the operator and non-defaulters.[80] However, some Australian courts suggest outright forfeiture may yet be attacked as either as a penalty or as interference with the rights of creditors in a liquidation.[81] Mindful of this, Australian and New Zealand JOAs conventionally include provisions where the defaulter obtains some value from the defaulted interest after settlement of outstanding obligations.

The clause will normally provide that, upon default, the operator will be obliged to issue to the defaulter a "default notice," and if default continues for more than a short period (typically two to six days), the non-defaulters are obliged to make up the financial shortfall immediately. Default is normally remediable by the defaulter at any time prior to forfeiture of the interest upon payment of the sum in default plus interest. Where the default period exceeds a specified period of time (typically 60 days), non-defaulters have the right to have the defaulter's interest forfeited to them in proportion to their percentage interests. Where the amount received from non-defaulting parties is insufficient to meet the shortfall, the operator will conventionally possess the power to borrow the necessary funds from outside parties and charge the costs to the non-defaulting parties.

During the period when the party is in default, a suspension of all its rights (but, of course, not its obligations) is in effect under the JOA. For example, the party will not be allowed access to any data nor representation on, or even attendance at, the operating committee. Should none of the non-defaulting parties wish to acquire the defaulter's interest, the JOA will normally provide the operations shall be abandoned, with each party, including the defaulter, paying each a percentage interest share of the costs of abandonment.

Complex legal issues arise from the default clause. First, where the defaulter is uncooperative in executing the necessary documents to transfer its interest under the JOA (and under the

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[80] Taylor et al., *supra* note 2, at 11.

[81] Mosaic OIL NL v. Angari Pty Ltd. (No.2) 8 AALC 780 (S. Ct. New S. Wales 1990) (per Young J); *see also* J. Waite & D. Dawborn, *Contractual Forfeiture of Joint Venture Interests: Are Such Clauses Enforceable?*, 11 OIL & GAS: L. & TAX. REV. 389 (1990).

relevant license) to the non-defaulting parties, the non-defaulters have to use recourse to legal proceedings for specific performance, thereby wasting time and money. To circumvent this, JOAs commonly include a power of attorney (usually in favor of the operator) which, if framed properly, will be irrevocable. If so this should transfer the interests to the non-defaulters. American practitioners in the U.K. suggest that such power of attorney might not withstand judicial consideration in U.S. courts, however.

As a general principle of law, moreover, a court will refuse to enforce a contractual clause presupposing the payment of money resulting from a breach of contract if the clause is regarded by the court as a penalty (as opposed to a proper attempt to calculate compensation for the breach).[82] The question then arises whether the clause is a form of liquidated damages or a penalty. If the clause is deemed to be a penalty clause, and this is purely a matter of interpretation for the court, the result is that it would be unenforceable in respect of that clause, although the entire agreement would not be void.[83] The principal argument that the clause is a penalty will be the fact the value of the defaulter's interest may be greater than the amount in default.

Two cases illustrate these issues. In the first, *BICC PLC v. Burndy Corp.*,[84] the defendant argued that a provision for forfeiture of a party's interest in certain patent rights, if it failed to pay its share of processing the patent, was a penalty. The Court of Appeal held it was not, conceding that a provision for forfeiture of property other than money nevertheless could be interpreted as punitative.

In *Jobson v. Johnson*,[85] the Court of Appeal held a power for the transfer of shares was a penalty. On the other hand, the purpose of such a clause is not necessarily to secure performance

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[82] For instance, the parties may agree that the debtor shall pay a sum as liquidated damages in the event of breach of contract. However, this sum must, at the time the contract is made, be a genuine pre-estimate of the loss likely to flow from the breach as opposed to being imposed in terrorem to dissuade the debtor from committing an act of default. *See* Dunlop Pneumatic Tyre Co. Ltd. v. New Garage & Motor Co. Ltd. A.C. 79, 86 House of Lords (1915).

[83] Many U.K. JOAs incorporate a provision that operates to sever any clause deemed void, illegal or otherwise unenforceable, from the rest of the JOA, thereby endevouring to prevent voiding of the whole agreement consequent on one portion being so deemed.

[84] 1 ALL ER 417 (1985).

[85] 1 WLR 621 (1989).

by imposing a penalty but rather to provide protection for all parties without which they would not be willing to incur the large commercial risks prevalent in UKCS operations. A default clause merely allows them, on having to finance a proportion of the defaulter's liabilities, to have a corresponding increase in their percentage interest.

Third, the relationship between the default clause and the English legal doctrine of "equitable relief" should be considered: previously a court could prevent the enforcement forfeiture provision from being enforced because it was not an equitable remedy. However, since 1982, a different conclusion can be drawn. An illustration of this can be found in *Scandinavian Trading Tank Co. AB v. Flota Petrolera*[86] where the plaintiffs chartered a vessel to the defendent. The default clause stated that if charterers failed to make payment of the monthly hire installment by the due date, the owners could withdraw the vessel from hire. The charterers asked the court to grant equitable relief with respect to this form of forfeiture. The Court of Appeal held that the doctrine did not apply to commercial transactions where the parties had dealt with each other at arm's length and had been of equal bargaining strength. It reiterated:

> It is of the utmost importance in commercial transactions that if any particular event occurs which may affect the parties' respective rights under a commercial contract, they should know where they stand.[87]

The House of Lords upheld the decision although it issued no specific dicta as to the courts jurisdiction in granting such relief with forfeiture clauses.[88]

However, in *BICC PLC* it was stated that the courts did have jurisdiction to grant equitable relief regarding forfeiture of parties' rights.[89] Since then, the courts will grant relief in situations where the clause is considered to be a penalty[90] although it is unclear what the situation would be with non-penalty clauses. Commentators[91] note the unwillingness of the House of Lords

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[86] Scandinavian Trading Tank Co. AB v. Flota Petrolera (The Scaptrade) 1 ALL ER 301 (C.A. 1983).

[87] *Id.* at 308 (per Robert Goff L.J.)..

[88] *Id.* 2 A.C. 694, 2 All E.R. 763, (H.L. 1983).

[89] BICC v Burndy Corp., *supra* note 84, at 427-428.

[90] *See Jobson v. Johnson supra* note 85.

[91] *See generally*, Taylor et al. *supra* note 2, at 54.

to define the limits of discretion. Following the decision in *BICC PLC*, it is unsettled whether English courts would be able to grant equitable relief in such circumstances.

Even if English courts[92] were to grant this equitable relief, the effects would probably be minimal. Since most JOAs include a 60-day grace period for remedying the default, the courts would probably take that period into account in determining whether or not to exercise the right. Scottish courts will normally uphold an irritancy (the equivalent of the English term forfeiture) even where the results would appear to be harsh. An example of this can be seen in *Dorchester Studios (Glasgow) Limited v. Stone*.[93]

Finally, the question again arises whether such a default/forfeiture clause is deemed to be a mortgage or a registrable charge in security for money lent. The U.K. Registrar of Companies has taken the view it is not and that such JOA provisions need not be registered at Companies House as charges. However a court may hold differently and it may be prudent to register the particulars under the companies legislation. This however, may affect relief against forfeiture as the defaulters may have a stronger claim if it were treated as such.

The forfeiture clause is not necessarily the only provision available for default. Two other types, the "withering" and the "purchase price" clauses, proceed on the same assumption, e.g. that the defaulter should at least retain some benefit for the money expended on joint operations before default. The withering clause appeared in the 1970s when smaller companies became concerned that they could be maneuvered into default. The clause operates to the effect that the defaulter does not lose his entire interest but can retain a reduced one, typically calculated on the basis of his total monetary contributions related to total joint venture costs. An advantage to this is less chance of such a provision being regarded as a penalty clause. The "purchase

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[92] Most U.K. JOAs use a forum selection (choice of laws) clause determining the applicability of English law even in cases where the operations are conducted on the Scottish continental shelf.

[93] S.C. 56 (H.L. 1985) The case provided that sub lease of a shop provided principal tenants were entitled to end the sub-lease if sub-lessees allowed any part of the rent to be unpaid for 21 days past due date. Sub-lessees were bound to remove since rent due at Martinmas (November 28th, 1972) was not paid until December 13th 1972 (the rent having been returned to the sub-lessee with notice that the principal tenants intended to enforce the irritancy.

price" clause, common in Australia and New Zealand, is based on the assumption that the non-defaulters are obligated to pay the defaulter the purchase price of his percentage interest, net of sums in default. Another type of clause is the "cross charges" clause where parties to the JOA could create cross charges over each other's interests. This is arguably untenable, because it is a slower and more complicated remedy to implement.

In Canada, the CAPL Operating Procedure makes provision[94] for the operator to have a lien on the interests of joint operators in the joint lands and in production wells and equipment. Where failure to pay continues for 30 days after a default notice has been served, the operator has a number of options. For instance, the operator can withhold information from the defaulting party, or take an automatic assignment of the defaulting party's share of production and joint property. Pertinent powers include the right to sell a joint operator's interest in the joint land. The proceeds of sale in this instance are to be applied, first to pay costs of default, and second to pay any residue to the defaulter.

The question of equitable relief from forfeiture has also arisen in Canada. The judiciary has, as in the U.K., managed to avoid answering the question directly as to whether the courts may be entitled to relieve the party of the effects of forfeiture provisions.[95]

XI. ABANDONMENT

Abandonment remains one of the most pertinent JOA issues. The U.K. position was significantly clarified by the Petroleum Act of 1987 (referred to in this section as "the Act") which made "provision for abandonment of off-shore installations and submarine pipelines." The Act sets out the statutory framework only and does not indicate the standard of liability imposed upon persons who have obligations thereunder. However, it does empower the Secretary of State to make Regulations to cover all aspects of the abandonment of offshore installations or submarine pipelines, although current U.K. governmental policy is not to make any detailed regulations but to address each case

[94] 1990 CAPL Operating Procedure Clause 505

[95] In Wetter v. New Pacalta Oils 2 W.W.R (NS) 290 (Alberta 1989) Chief Justice O'Connor refrained from commenting upon whether the instant case was one where relief from forfeiture could be given under the Judicature Act, R.S.A. 1989 s.10.

individually. The Secretary of State can, by written notice, require a person to submit a program setting out measures proposed to be taken in connection with the abandonment of an offshore installation or submarine pipeline.[96]

Licensees have no obligation under the Act to execute their own agreement as to abandonment or include provisions relating to it in the JOA, although there is some indirect encouragement to do so.[97] The person who receives the Section 1 notice has a statutory obligation to ensure the abandonment program is carried out. Allocation of liabilities among the licensees is often envisaged to be a matter for the parties to settle (i.e., within the JOA or otherwise).[98] The Act does state it shall be the duty of each of the persons who submit the abandonment program to ensure it is implemented.[99]

Modern JOAs incorporate provisions for abandonment ab initio, typically requiring the operator to produce an annual abandonment programe and budget, typically commencing with an Annex B submission.[100] Furthermore, the scope of the JOA must be expanded to include abandonment, and there are necessarily drafting changes to the enumerated "standard," especially in relation to the main indemnity relating to a participant's percentage interest share of costs and liabilities.

XII. SECURITY FOR ABANDONMENT

The JOA mechanics of abandonment differ little from those affecting development; hence JOA provisions in this context are minimal. In the context of a JOA executed now but operative substantively only in the future. The possibility of a party being unable to meet its share of abandonment liabilities is a worrisome probability. For this reason, some form of security against failure to meet such share of the costs is needed, the reason being that if no such provisions were made, the other parties would become liable to pay the defaulter's share with no practical recourse against the defaulter. The British Government itself

[96] Section 1(1) Petroleum Act 1987.

[97] *Id.* at § 3(2) & § 3(3)

[98] Current government policy is understood to involve itself in intra-licensee matters only as a last resort.

[99] Section 8 Petroleum Act 1987.

[100] Submission of a Development and Production Programme for the Consent of the Minister: Model Clause 17 (1988 Regulations) of the License.

has indicated that while no such provisions are contained under statute, it prefers that co-licensees should enter some form of agreement to provide security.[101]

Currently three broad approaches to security for abandonment in UKCS JOAs can be identified:

> (i) to include an "agreement to agree" where the clause will state that the parties shall negotiate in good faith to execute an abandonment security agreement before some future date which is usually before a development programme is submitted to the Secretary of State since this ensures the "momentum" is present which encourages them to do so.[102] As a general principle of contract law, an agreement to agree does not create any binding obligations, but some JOAs nonetheless provide sanctions for failure to abide by the "agreement to agree." One possible provision is that the dissenting party can either agree to become a party to the abandonment agreement which others have already accepted or be deemed to have made a "non-consent" election in relation to the development. A provision of agreement to agree in a JOA may also include provisions pertaining to the sharing of liabilities, obligation to provide security and the adequacy of security.[103]
> (ii) to include provisions similar to those outlined in (i), but to strengthen them by making it a default event for any party not to have executed an abandonment security agreement prior to submission of Annex B; however, and in relation to default clauses, such a provision should be regarded with suspicion until tested judicially.
> (iii) to include a complete agreed abandonment security agreement as a schedule to the JOA, requiring its execution prior to submission of Annex B (typically with default attached), and allowing changes to the agreement only where dictated by statute or regulation, ie deliberately minimizing the scope for re-negotiation.

The cardinal principles for laying down rules as to the nature of a security are acceptability and flexibility.[104] No strict or rigid rules should be laid down, as there are variable factors personal to each company which make this rigid stance untenable. The security to be provided must be acceptable to the other parties

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[101] Taylor et al., *supra* note 2, at 87.
[102] *Id.* Appendix Clause 6.10.3.
[103] *Id.* at 85.
[104] *Id.*

and one view is that, provided this requirement is met, each company should have the right to choose its own type of security. The contrary view is that each company should exhibit the same type of security so that each incurs the same costs or provision thereof.

The final point that arises is the situation where a company fails to provide acceptable security, or the security provided becomes inadequate or unacceptable. The simplest solution is to treat the situation as analogous to default upon a cash call, rendering the defaulting party liable to forfeit his interest. One problem with this approach is the clause may be vulnerable to attack by the courts as a penalty provision. Another problem is forfeiture of a party's interests will only be of benefit when such interest is of value. At the end of field life when abandonment is necessary, the value of the interest will inevitably be substantially lower than the liabilities which have to be borne.

XIII. CONCLUSION

Some solutions to the problems of the JOA on the UKCS have been advocated[105] yet none of these provide all—or even most—of the answers. While JOAs tend to be classified as "black-letter" law subjects, they do not exist in a vacuum. Any comparative study of joint operating agreements must recognize that different legal jurisdictions invariably tackle similar physical or technological problems in a diverse manner. Indeed, the ethos of a particular jurisdiction is driven by various cultural, social, political and economic factors.

Consequently, the law broadly reacts to these human factors with a purpose that is often labelled as "public policy." As one celebrated jurist suggests:

> [o]n the other hand, in substance the growth of the law is legislative. And this in a deeper sense than that what the courts declare to have always been the law is in fact new. It is legislative in its grounds. The very considerations which judges most rarely mention, and always with an apology, are the secret root from which the law draws all the juices of life. I mean of course, considerations of what is expedient for the community concerned. Every important principle which is developed by litigation is in fact and at bottom the result of

[105] *Id.* at 89.

> more or less definitely understood views of public policy. . . .[106]

Hence, comparative law analysis searches for functionally equivalent rules that attempt to solve the same problem or fulfill the same role. Included here is the energy sector and the narrower subject of JOAs.

Limits clearly restrict the validity of any comparative law study. But these should not obscure similarities. American oil and gas law has, to varying degrees, been persuasively received in many jurisdictions partly because the petroleum exploration and exploitation industry has been dominated by American capital and capability. The U.S. and Canadian oil and gas industries are arguably the most sophisticated in terms of history, profile and intensity of the regulations. Part of this success stems from land tenure systems in Canada and the U.S., where a significant proportion of the population owns real property rights to petroleum in situ. The implementation of public policy as an efficient regulatory superstructure is thus needed in order to protect the interests and expectations of petroleum producers, transporters and distributors.

Joint operating agreements are the contractual nexus balancing exploration and production expectation interests against conflict with a particular regulatory régime. In the U.K., since there are less players in the petroleum field than in North America, this explains the absence of comparative judicial authority concerning oil and gas joint operating agreements, as well as the failure to adopt an industry wide standard form. Arguably, the U.K. oil and gas industry has displayed less of an adversarial and more of a conciliatory attitude toward dispute resolution than surfaces in North America. Nevertheless, within the next generation, it is clear that great creativity and inventiveness will be required of the legal profession to devise new answers to the most intractible problems of joint operating agreements.

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[106] OLIVER WENDELL HOLMES, THE COMMON LAW 35-36 (1912); *see also* SILAS BENT, JUSTICE OLIVER WENDELL HOLMES, 148 (1932).