venturers have the ability to withhold consent in their "reasonable discretion". Normally a properly drafted pre-emption clause would not be construed as a restraint on alienation at common law[29], but in my view use of stronger wording raises a real prospect of having the clause declared void because it offends that rule.

Finally, it should be noted that in the North Sea context, a clause subjecting assignment to the consent of the other parties would not fit within the definition of "pre-emption arrangements" and therefore the parties are free to agree on whatever wording they wish without having to obtain special permission from the DTI.

4. Instead of drafting in minute detail to cover every possibility, insert a more general clause stating what the intent is. This will invite a Court to follow the creative lead of the Court of Appeal in the *Texas Eastern Corporation* case[30]. I envisage that this would take the form of an over-riding statement of intent that the parties will deal with each other in good faith in offering interests to each other first. Non-exhaustive examples could then be given of the types of transactions that would be caught by the provision. It will take a few brave drafters to head down this path, but I believe in time this is the type of clause most likely to provide the type of liberal interpretation the parties originally intend, that is, an emphasis on substance over form. It should be noted that drafters have already stepped in this direction by adopting the "bona fide" rider in respect of package deals.

AIPN 2002 MODEL FORM JOINT OPERATING AGREEMENT IN OIL AND GAS JOINT VENTURES

Cátia Malaquias Miles*

The "Joint Operating Agreement" is the standard commercial agreement that governs the relationship between joint venturers in oil and gas exploration and developments.

The Association of International Petroleum Negotiators ("AIPN") has published a 2002 version of its international Model Form Joint Operating Agreement ("2002 Version"), which was first published in 1990 ("1990 Version") and was followed by a revised version in 1995 ("1995 Version"). Like its predecessors, the 2002 Version is the result of a co-operative effort by a number of companies, lawyers, engineers, geologists, geophysicists, accountant and consultants in the oil and gas industry.

In publishing the Model Form Joint Operating Agreement, the AIPN has sought to provide a model for joint venture operations. The model aims to be a flexible one, to accommodate the preferences of individual parties and the different legal regimes that may govern the joint venture operations. It achieves this by providing text alternatives for many of its provisions as well as drafting and guidance notes which call attention to legal issues that may be relevant to the context in which the document is proposed to be used.

---

29 *Allstate Prospecting Pty Ltd v Posgold Mines Ltd*, supra; "The Effect of the Rule against Perpetuities on Pre-emptive Rights in Joint Ventures" by P J Allen and R Cottee [1982] AMPLJ 190.

30 Supra at footnote 13.

* Blake Dawson Waldron.

1. AN "INTERNATIONAL" JOINT OPERATING AGREEMENT

The development of Model Form Joint Operating Agreements by the AIPN reflects a move, at an international level, towards a greater harmonisation of joint venture agreements. This move has been driven in part by a desire of the international oil and gas industry to streamline the process of negotiating these types of arrangements and minimise its very high transaction costs by providing a model that is broadly accepted by the international oil and gas industry as a reasonable, practical and tested document.

The creation and use of internationally accepted model form joint operating agreements in the area of oil and gas exploration and development seems sensible given that, broadly speaking, all joint operating agreements have certain basic elements in common. For example, all joint operating agreements will provide for:

(a) the pooling and co-ownership of project assets;
(b) the establishment of a method for the conduct of the joint operations by which certain parties are given the authority to make certain decisions in particular circumstances (eg the operator, all the joint venture parties or, in the case of sole-risk projects for example, some of the joint venture parties);
(c) the apportionment of risks among the parties (including the operator);
(d) the participation by each party in costs; and
(e) the participation by each party in production or revenues.

Nevertheless, due to individual national legal environments as well as technical and economic factors prevailing in particular regions in the world, many distinct forms and practices in negotiating joint venture documentation have emerged across those regions. For example, this is certainly the case within Australia, which, unlike some parts of the world, has a well-established system of laws governing oil and gas exploration and developments. Over time, this has contributed to the emergence of an Australian "style" of joint operating agreement.

The existence of region-specific forms and practices in negotiating joint venture documentation in part explains the initial resistance of some sectors of the international oil and gas industry (eg many Australian companies), to the use of the AIPN's Model Form Joint Operating Agreements. The 1990 Version in particular, was strongly characterised by a US or Texas-based oil and gas approach to drafting and negotiating joint operating agreements, which reflected the origin of most of its drafters. Its format and terms were quite different to the "style" of joint operating agreement generally produced in Australia and, while the document was designed to be adapted to suit the preferences of the individuals parties to the agreement and the different legal regimes governing operations, this version in particular required significant modification before it could be used in the Australian context.

While the 1995 Version made some improvements to the model, the 2002 Version reflects a clear attempt to produce a document that is "international friendly" and move away from the US or Texas-based oil and gas approach which was more strongly evident in the earlier versions. In this regard, the drafting and structure of the document have been simplified by the deletion of options that were not often used, the introduction of new or clearer definitions and the use of examples as a means of clarifying the operation of certain provisions. Major revisions have also been made to areas such as operator personnel and authority, Health, Safety and Environment, budgets, sole-risk operations, disposal of hydrocarbons (eg to accommodate gas projects), default, assignment and dispute resolution.

2. ISSUES FOR USERS OF 2002 VERSION

2.1 General

The 2002 AIPN Model Form Joint Operating Agreement can be a useful tool, whether used as a base document which is adapted to suit domestic law and conditions or as a source of terminology and clauses to supplement local joint operating agreements or to provide alternatives (eg in the case of impasse) which are accepted by negotiating parties as conforming with generally accepted industry practices. Ultimately however, its utility will depend on the ability of negotiation parties to understand the strengths and weaknesses of the document and the extent to which it needs to be adapted to accommodate the relevant legislative framework.

While it is not within the scope of this commentary to consider all the provisions of the 2002 Version that have been amended or which may be problematic in particular circumstances, the provisions discussed in more detail below present some interesting issues and should be noted by joint venture negotiators who are considering using or adapting the 2002 Version.

2.2 The underlying government "Contract"

A significant feature of the 1990 Version was that it assumed the existence of an underlying "Contract" between the joint venturers and the national government owning the relevant petroleum resources.

Perhaps because of its widespread use internationally (although not in Australia), the production sharing contract ("PSC") was used as the model for the "Contract". The petroleum permit is essentially the domestic equivalent of the PSC.

The 1995 version sought to accommodate non-PSC regimes such as Australia and was published with a series of instructions explaining steps for eliminating the PSC element of the document. However, the 2002 Version takes the matter one step further by incorporating relevant statutes and regulations in the definition of "Contract" so that references to the requirements of the "Contract" are still applicable where no such government contract exists. However, it is still important to be aware of the "Contract" assumption in the 2002 Version, as references to the "Contract" occur frequently throughout the document and may not always be relevant or appropriate in the circumstances.

2.3 Standard of care and liability of Operator (article 4)

The 2002 Version generally imposes on the Operator an obligation to exercise "good and prudent practices as are generally followed by the international petroleum industry under similar circumstances". However, under article 4.6, the Operator's liability is either extremely limited or, alternatively, the Operator has no liability in respect of any damage or loss resulting from its performance or failure to perform its obligations under the document, except to the extent of its participating interest. Commonly, Australian joint operating agreements impose on the Operator liability only in respect of direct losses caused by the "wilful conduct" of the Operator (and often its senior supervisory staff). This approach is consistent with the alternative in article 4.6(C) which effectively imposes on the Operator liability in respect of direct losses caused by its "Gross Negligence/Wilful Conduct". The article also allows negotiators to further select the extent to which the Operator is liable (eg all such losses, losses up to a specified amount, etc).

It is worth noting the use of the term "Gross Negligence/Wilful Misconduct" in article 4.6. This term was introduced in the 2002 Version and reflects the attempt to "internationalise" the document by incorporating the language of wilful misconduct used in Australia and other common law jurisdictions.

2.4 Non-consent and sole risk operations (articles 5.13 and 7)

The 2002 Version has significantly revised the provisions dealing with the rights of JVPs to undertake sole-risk projects and to elect not to participate in proposed joint operations. These provisions are now quite comprehensive and provide workable alternatives. They may be a useful model or reference in that many joint operating agreements do not adequately deal with these issues.

Broadly, the effect of the provisions in articles 5.13 and 7 is to allow sole risk and non-consent elections wherever appropriate.

Sole-risk
Article 5.13(A) of the 2002 Version permits JVPs voting in favour of certain proposals that are not approved by the Operating Committee to undertake those proposals on a sole risk basis. Operations that are carried out on a sole risk basis under the document are defined as "Exclusive Operations".

The types of operations that may be carried out on a sole risk basis will depend on the alternatives selected under article 7.1(D).

The first alternative provides that any operation that may be proposed and conducted as a "Joint Operation" (ie operations that could have been carried out by the Operator pursuant to the joint operating agreement and the costs of which would have been chargeable to all JVPs), other than an operation pursuant to an "approved Development Plan", may be conducted as an Exclusive Operation.

The second alternative provides that only the following types of operations may be proposed and conducted as Exclusive Operations:

(a) drilling and/or testing of exploration wells and appraisal wells;
(b) completion of exploration wells and appraisal wells;
(c) deepening, sidetracking, plugging back and/or re-completion of exploration wells and appraisal wells;
(d) development of a commercial discovery;
(e) disposal of production; and
(f) any other operations specifically authorised to be undertaken as Exclusive Operations under the document.

There is also a further optional article which provides that, except for Exclusive Operations relating to deepening, testing, completing, sidetracking, plugging back, re-completions or reworking of a well originally drilled to fulfil the "Minimum Work Obligations", no Exclusive Operations may be proposed or conducted until the Minimum Work Obligations are fulfilled.

Non-consent
The optional provision in article 5.13(B) of the 2002 Version permits JVPs to elect not to participate in certain operations that are approved by the Operating Committee and that could have been conducted as Exclusive Operations.

Further, where a party has elected not to participate in the approved operations, a party which had initially consented to the operations may request a further vote on the matter by the other consenting parties. This allows parties which agreed to participate in an Exclusive Operation before they knew that such operation would be undertaken by less than all the JVPs, to reconsider

their participation in light of the fact that they would be required to incur a share of the risk and costs which would be greater than their participating interest under the joint operating agreement.

Premiums – re-instatement of rights to participate in sole-risk
JVPs who elect not to participate in Exclusive Operations have the right to re-instate their rights to participate in a development resulting from the operations, by paying a premium to the consenting JVPs. However, if they fail to do so within a specified period, that right is lost and they are deemed to have withdrawn from the joint operating agreement to the extent that it relates to that development (article 7.4).

The premium may be paid in cash or by payment of cash calls made in respect of the participating interest of the consenting JVPs. The option to pay an in kind premium has been deleted in the 2002 Version.

In Australia, the payment of the premium in cash may have tax consequences for the consenting JVP receiving the payment and should be considered carefully.

2.5 **Default (article 8)**
Broadly, the default provisions in the 2002 Version reflect a US approach. The following remedies are provided as optional alternatives in 8.4(D):

(a) forfeiture of the participating interest of the defaulting JVP in favour of the other JVPs (including a further option for expedited forfeiture in the case of a second default by the defaulting JVP occurring within a specified period); and
(b) a "buy-out" of the defaulting JVP's interest by the JVPs wishing to acquire that interest. The right to require the "buy-out" is enforceable by either a majority interest of non-defaulting JVPs or each of the non-defaulting JVPs. Further, if the defaulting JVP does not accept the valuation of its participating interest which has been provided by the acquiring JVPs, an expert will be appointed to determine the "fair market value" of the interest.

In Australia, the normal default remedy, at least in the case where there is an advanced asset (eg where the JVPs have proceeded to develop a discovery), is the exercise of cross charge in favour of the non-defaulting JVPs. It is common for joint operating agreements to require each JVP to grant a cross charges over the whole of its participating interest in favour of the other JVPs, to secure all its obligations under the joint operating agreement.

In Australia, there is a risk that the forfeiture alternative may be construed as a "penalty" by the courts. This risk is perhaps greater where the default triggering the forfeiture occurs during the development phase of joint venture operations. Therefore, it may be preferable to adopt the "buy out" rights rather than the forfeiture alternative for joint operating agreements governed by Australian law.

2.6 **Transfers and change of control (article 12)**
The transfer provisions in article 12 of the 1995 Version have been significantly expanded in the 2002 Version.

Article 12 requires the JVPs to give their consent to any "Transfer" or "Change in Control" (except for a transfer to an affiliate in circumstances where the transferor agrees to remain liable for the performance by the affiliate of its obligations). Consent is not to be withheld unless the transferor fails to establish the financial and technical capability of the transferee.

Importantly, article 12 now addresses a number of issues that were not expressly addressed in earlier versions, such as the requirements for and consequences of a "Change in Control" in a JVP,

whether a transfer of the Operator's participating interest results in a transfer of the operatorship to the transferee and the valuation of non-cash consideration offered by an intending third party purchase of a JVP's interest. Article 12 also introduces alternative remedies in the event that a JVP breaches the requirements for a transfer or change of control under the document.

Change of control clarification
A definition of "Change in Control" has been inserted in the 2002 Version, to avoid some of the confusion that was inherent in the transfer provisions in previous versions of the document. It captures both direct and indirect changes in *control* (ie 50% of voting power) of a JVP through a merger, sale of shares or other equity interests. The definition also introduces a further threshold before a "Change of Control" is deemed to have occurred, by requiring the market value of the JVP's interest to represent more than a pre-agreed percentage of the total value of the relevant transaction.

Transfer of Operator's interest
New article 12.2(B) expressly provides that the Operator remains in that role, even if it has transferred a portion of its participating interest. In the event of a transfer of the whole of the Operator's participating interest (other where the transfer is to an affiliate), the Operator is deemed to have resigned. In the event of a transfer to an affiliate, the affiliate automatically becomes the successor Operator except that the transferring Operator remains liable in respect of the affiliate's performance of its obligation as Operator.

Pre-emptive rights and rights of first negotiation
Article 12.2(F) contains comprehensive optional alternatives for the grant of pre-emptive rights (applying after the intending transferor has fully negotiated the terms of the transfer) and rights of first negotiation (applying before the intending transferor has entered into any written documentation in respect of the proposed transfer to a third party) in the case of a proposed transfer or change of control.

One interesting aspect of the above pre-emptive rights provision is that it deals with the situation where the offer by the third party transferee does not include cash consideration only. In such cases, the other JVPs can still match the third party's offer by agreeing to pay the cash value ascribed to the participating interest to be sold.

It is also clear from the provision that, where the proposed transfer is part of a package sale or a sale involving other properties, the pre-emptive rights terminate if the package sale terminates without completion (see in alternative option 1 of sub-paragraph (F)(3) in article 12.2).

It is also worth noting the optional alternatives under article 12.3(C), which provide for the grant pre-emptive rights or rights of first negotiation to the other JVPs in respect of the participating interest of the JVP that is subject to a Change in Control. It is suggested that negotiating parties should consider carefully before selecting either of these optional alternatives given that they give rise to significant and onerous restrictions on the ability to deal with subsidiary companies. Further, article 12 does not seem to provide any exception to a "Change in Control" in public companies.

Remedies for breach of transfer/change in control provisions
Article 12.1(A) specifically addresses the remedies that are available to the JVPs in the event that there is a "Transfer" or "Change in Control" which occurs without compliance with the requirements of that provision. The following two alternatives are provided:

(a) the JVPs are entitled to enforce specific performance of the terms of article 12 and claim damages. There is also an express acknowledgment that monetary damages alone are not an adequate remedy for a breach of a JVP's obligations under the provisions; and
(b) the JVPs are entitled to claim liquidated damages, which are equal to an agreed percentage of the "Cash Value" of the relevant participating interest (ie its market value or a portion of the consideration being offered by the proposed transferee). The option also expressly states that the parties agree that "it would be difficult if not impossible to determine accurately the actual amount of damages suffered by the other party" and that the liquidated damages are a reasonable "approximation" of the damages suffered by the other JVPs.

Concerning the above statement in alternative 2 of article 12.1(A), it raises the question of whether the liquidated damages provision would be struck down by the Australian courts as a "penalty" on the basis that it has not been agreed by the parties that the liquidated damages are a genuine pre-estimate of the loss suffered by the other parties as a consequence of the breach. The imposition of an obligation to pay liquidated damages in respect of a breach of "Change in Control" restrictions does not represent normal practice in Australia.

Mortgagee as transferee and liability of transferor for decommissioning
The 2002 Version has significantly expanded the definition of "Transfer". It now includes a sale, assignment, encumbrance (ie mortgage, lien, pledge, charge or other encumbrance) or other disposition by a JVP of any rights or obligations derived from the "Contract" (ie the relevant permits in non-PSC regimes) or the joint operating agreement, other than its rights to any credits, refunds or payments under the joint operating agreement.

It seems unusual to treat an encumbrance as a "Transfer" as this would apparently place a mortgagee in the position of a transferee with specific obligations to perform the obligations of the transferor, which may have unintended consequences. It is suggested that it may be more appropriate to deal separately with transfers and encumbrances and their respective requirements and consequences.

Finally, article 12.2(C), which is an optional alternative, should also be noted. It allows the negotiation parties to select whether the transferee and the transferor are liable for any costs of plugging and abandoning well and decommissioning facilities. Given the obligations imposed under Australian law in relation to decommissioning, it is suggested that this alternative should be selected for domestic joint operating agreements.

2.7 Natural Gas (article 9.3)

The 2002 Version seeks to address the situation where the JVPs, having made a natural gas discovery, wish to proceed to development and will need to make arrangements for the disposal of the gas.

The provisions are in article 9.3 provide two alternatives:

(a) the first is essentially a "heads of agreement" under which the JVPs will enter into a gas balancing agreement and a gas disposition agreement for common-stream delivery by the JVPs. Marketing of gas remains outside the scope of the joint venture; and
(b) the second is a mere "agreement to agree" to future gas disposals. This provision is not likely to be enforceable under Australian law.

Given that gas projects are becoming increasingly common and important in the energy industry and many joint operating agreements contain limited, if any, provisions relating to the discovery of natural gas, it may be worth considering the provisions in article 9.3.

2.8 **Disputes (article 18)**

Briefly, article 18 as revised under the 2002 Version provides several options for dispute resolution, including alterative dispute resolution, expert determination and arbitration. Article 18 also provides a wide number of options for arbitration under a variety of arbitral rules and institutions such as, for example, the International Chamber of Commerce, the London Court of International Arbitration, the American Arbitration Association, the UN Commissions of International Trade Law (UNCITRAL), etc.

2.9 **Taxation**

It is worth keeping in mind any tax consequences that may result from the adoption of the provisions contained the 2002 Version, such as, for example, any consequences of the payment of cash premiums for the re-instatement of JVPs rights in sole-risk operations.

Tax issues may become particularly complex in international operations, where the JVPs and joint operations will be subject to multiple taxation (ie in the country regulating the operations and in the country of origin of each joint venture party).

Where negotiators are considering using the 2002 Revision in respect of Australian operations, it may be worth considering introducing a further article expressly addressing any GST issues. For example, the JVPs may elect to form a "GST joint venture" under the GST legislation, to enable input tax credits to be claimed on behalf of the joint venture.

3. **CONCLUSION**

Each revision undertaken by the AIPN has brought about stronger global acceptance of the Model Form Joint Operating Agreement. While there appears to be some to its use in Australia, it is suggested that Australian companies involved in international joint operations are increasingly using the AIPN document in negotiating joint ventures. In the domestic context, while companies have traditionally preferred to use Australian-style joint operating agreements, the 2002 AIPN Model Form Joint Operating Agreement can still be a useful document or source for parties negotiating joint venture arrangements.

However, like all model form agreements, the provisions contained 2002 Version should be carefully considered for their suitability to the particular circumstances and the legislative framework in respect of which they are intended to operate.

The AIPN also publishes the following other model form agreements which are available on the AIPN's website (www.aipn.org):

(a) confidentiality agreement;
(b) international study and bid group agreement;
(c) consultant agreement for business development in a host country;
(d) lifting agreement;
(e) secondment agreement;
(f) services agreement; and
(g) accounting procedure.

A model form gas sales agreement and a farmout agreement are currently being developed for publication by the AIPN.