

# Parties and participating interests

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## 3. **Parties and participating interests**

Essential to the proper working of the JOA is the identification of the persons that will be party to the JOA, and also of any persons that might support the obligations of those parties, and the quantification of each party's interests under the JOA.

The management of the admission of new parties to, and the withdrawal (or even expulsion) of parties from, the JOA is addressed separately elsewhere (see variously Chapters 10, 11 and 14).

The JOA might also need to legislate for the possible participation of an entity which represents the interests of the government which has granted the concession, and whether a particular party might be the recipient of a financial carry from any of the other parties.

### 3.1 **The parties**

The JOA will identify each party as it exists as at the execution date (2.1), through the opening recitals in the JOA. This act will record the initial parties to the JOA; but where during the lifetime of the JOA there are any changes in the identity of the parties, the JOA will not explicitly track such changes. Consequently, the history of changes in the identities of the parties to the JOA will be discoverable only from an analysis of the JOA and the documents which record any later transfers of interests or any changes of name in respect of a party. Where a JOA has been in existence for some time, the forensics of establishing the chain of title through the parties over the years can be a formidable task.

A more certain (but not a common) approach is to require the operator to append to the JOA a schedule of the current parties from to time, and to revise and circulate that schedule to all parties in the event of any changes in the identity of any of the parties. This change might also be recited through a combined novation and amendment agreement (17.3), which will be supplementary to the JOA.

The definition of a party should be expressed to include that party's successors in title and permitted assignees,<sup>1</sup> and the JOA should be expressed to transition to the benefit of any such successors or assignees.<sup>2</sup> In the latter case, any requirement in the JOA for a novation agreement to condition the transfer of the interests of a party under the JOA to another person (10.2) should ensure that such a transition to an

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1 AIPN JOA preamble, §20.4; OGUK JOA §1.1.

2 AAPL JOA 810 §26.5.6; CAPL JOA §25.03.

assignee is expressly effected. The reference to successors is intended to ensure that where a party undergoes any event of merger, amalgamation or other corporate transformation, the JOA will continue to bind that party or any party which is the product of such an event.

Because the JOA represents the horizontal relationship between the parties to, and in respect of their interests in, the concession (1.2), the popular expectation is that there will be complete symmetry between the holders of the concession and the parties to the JOA. This is usually the case, but is not always necessarily so:

- Non-JOA parties – it may be that there are certain holders of the concession that are not also party to the relevant JOA. This happens, for example, on the UKCS, where a licence which is awarded to explore for and produce petroleum governs more than one operating interest area (or ‘block’). The parties to each particular block will have their own JOA, and any other persons (that are recorded on the licence but are not also participants in the particular block) will not be party to that JOA.
- Non-concession parties – it may be that some of the parties to the JOA are not also party to the relevant concession. This happens, for example, where the JOA includes the appointment of a contracted operator (6.5), where any collateral support which has been given by another person in respect of a party’s commitments under the JOA is recited within the terms of the JOA rather than separately (see below), or where one of the parties has entered into an illustrative agreement (see below).

One of the parties to the JOA might additionally be agreed by the other parties to act as the designated operator in the performance of the joint operations (6.2). Thus, this party will have two distinct capacities under the JOA – as the operator and as a party.<sup>3</sup> The role as operator is quite distinct from the role as party, and undertaking the role of operator should afford no special privileges to the party which does so in its capacity as a party. How this duality of interests operates in practice is demonstrated, for example, by the cashcall or invoice request mechanisms under the JOA (16.2), whereby the operator will cashcall or invoice all of the parties, including itself, for the costs of conducting the joint operations.

The parties will be keen to preserve the financial and operational integrity of their joint venture and consequently the ability of a party to transfer its interests under the JOA to a third party will usually be closely controlled within the JOA. This aspect is addressed in detail in Chapter 10. Any nervousness about the identity of a new party to the JOA will abate where a party withdraws from the JOA (see Chapter 11), or commits a default which results in its interests being forfeited (see Chapter 14), as in either case the interests of the departing party is intended to pass to the remaining parties.

### 3.2 Collateral support

The parties will have come together initially in the JOA based on the premise that each is able to meet its respective share of the financial commitments arising under

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3 CAPL JOA §3.02.

the JOA. A key feature of the manner in which the JOA is expected to operate is that the parties will make timely payments in respect of the operator's cashcalls or invoice requests as they fall due (16.2). The JOA will recite a mechanism for dealing with a party's payment failure (see Chapter 14), but that should not be regarded as a substitute for ensuring the initial and ongoing creditworthiness of each party.

At the point when they first form their joint venture, the parties might require the provision of some form of collateral support by each party in respect of its respective obligations under the JOA. There could be an exception to this principle where a particular party has an inherent level of creditworthiness which would obviate the need for such a request, if at the date of execution of the JOA a party is of sufficient financial worth that the provision of some form of collateral support in support of its JOA commitments is obviously not necessary.

If this is not the case, some form of collateral support may be required in respect of that party prior to execution of the JOA. Similar considerations will apply where there is a transfer of a party's interests (see Chapter 10), and the provision of collateral support may be required in respect of an incoming transferee.

However, the typical process of negotiation of a JOA rarely tends to place the institution of collateral support in respect of the parties' obligations near the top of the commercial issues list. In part, this may be attributed to the expectation that the parties are and will be suitably solvent and expect to perform fully their JOA obligations, due to their reluctance to risk the adverse reputational risk associated with a default or to jeopardise the prospective economic returns from the JOA. Consequently, a discussion about the need for collateral support is often regarded as awkward and inappropriate.

This hypothesis is more tenable when the JOA and the concession are in their infancy and the prospects for petroleum production and revenue returns are high, but as the JOA moves through its customary lifecycle (4.1), eventually towards governing the end of the useful life of the underlying assets, then an attitude which has a greater appreciation of the need for collateral support might be more appropriate. The obligations of the parties to make payments in respect of the JOA will vary over the lifetime of the underlying petroleum project (1.8), and from that analysis it will be apparent that the need for collateral support could be at its greatest when the petroleum project is consuming cash, rather than when it is generating revenue.

The liability of a party to meet its share of the costs of decommissioning the petroleum production, processing, storage or transportation infrastructure used in the performance of the joint operations, and the provision of collateral support in respect of that liability, is considered separately (13.3).

The requirement for a party to procure collateral support might be limited to application in respect of the exploration and appraisal phase only (4.1), if the parties are comfortable that the decommissioning phase will bring its own requirements for collateral support (13.3), and that in the production phase the existence of a party's produced petroleum entitlements (9.1) will give its own remedies to apply in respect of a party's default (see Chapter 14).

Where there is a default by a party, it will be an option for the non-defaulting

parties under the JOA to consider making recovery under any form of collateral support which has been put in place in respect of a party's obligations under the JOA. However, for this to have a realistic chance of application, the parties will need to have focused on getting this collateral support in place for a party simultaneously with (and as a condition of) that party becoming a party to the JOA.

None of the AAPL JOA, the AIPN JOA or the OGUK JOA prescribes a requirement for the provision of collateral support by the parties, although the OGUK JOA does require the parties to commit to an agreement which provides security for the eventual costs of decommissioning prior to the submission of a development plan in respect of a discovery.<sup>4</sup>

The CAPL JOA allows the operator to call for the provision of security by a non-operating party in respect of its share of the costs of the joint operations if the operator has concerns about the creditworthiness of that non-operating party. The form of that security is not specified, although reference is made to the possible provision of an irrevocable standby letter of credit.<sup>5</sup>

The reaction of governments to the suggested need for the provision of collateral support by the parties in respect of their obligations under the JOA is variable. While this is principally an issue to be considered between the parties to the JOA, the support of the government agency which is responsible for overseeing the grant of a concession for the principle of constituting the provision of collateral support under the JOA as a condition of participation in a concession may be helpful.

However, as new petroleum provinces emerge and seek to attract investment, or as mature petroleum production provinces decline, there may be a temptation on the part of any government to lower the bar for new entrants in order to maintain production for as long as possible, and imposing stringent collateral support commitments might be inconsistent with such an approach. The reluctance of the government to require collateral support may be evidenced in respect of the approval of the terms of the JOA (2.1) and also in respect of what collateral support the government might require from a party in its capacity as a concession holder.

A party might argue that if it has not, in its capacity as a concession holder, been asked to provide any collateral support under the terms of the concession, then neither should that party be required to provide any collateral support under the terms of the JOA. However, this convenient argument overlooks the reality that under the concession, the liability of the concession holders to the government for performance of the obligations will be joint and several (1.2), and so the government might be more relaxed about the need for the provision of collateral support in respect of any individual party since it has the right to look at any or all of the parties in order to cover any individual party's failure. Under the JOA, however, the liability of each party will be several and this might prompt a different attitude between the other parties.

Where appropriate, the collateral support which could be provided in respect of a party's JOA obligations might take the form of a corporate guarantee, a bank

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4 OGUK JOA §26.3, and see Chapter 13.

5 CAPL JOA §5.03.

guarantee (or similar letter of credit or commitment), or some form of default insurance (where each other party will be named as co-assureds).

The commitment of a corporate guarantor in respect of a party might be recited in the body of the JOA (and that guarantor will be an additional signatory to the JOA – see above), so that the guarantor gives a directly enforceable commitment to each party which is intended to be a beneficiary of that commitment. Alternatively, such a guarantee commitment could be stated in a separate document, outwith the JOA.

Notwithstanding that a party has procured no collateral support in respect of its commitments at the outset, during the lifetime of the JOA the party's financial situation may deteriorate; and given the often significant duration of a typical JOA, this is a real possibility. The JOA might therefore provide that in the event of such a deterioration (which could be determined according to the subjective opinion of any of the other parties or according to an objective test, such as audited proof that a defined financial ratio has been breached or the loss of an independently certified credit rating), the affected party should be required to procure some collateral support (a process sometimes known as 're-guarantee').

In most other commercial agreements the failure of a party to meet its obligation to procure such collateral support would trigger an event of default, so allowing the other parties to terminate the agreement in respect of that failing party. However, this is rarely the case in a JOA, where the provisions which define a party's default are typically written more restrictively (2.1).

### 3.3 Participating interests

Most concessions do not create an individual interest in respect of each concession holder. Rather, the concession will be awarded to all concession holders together, with joint and several liability (1.2). Thus, it will be a responsibility of the JOA to create the individual interests of the parties.

As a result, what is sometimes called the 'interests provision' in the JOA will recite the participating interest (PI) of each party and each party's PI will represent the undivided, individual interest of a party (expressed as a percentage of the aggregate of the PIs of all the parties) under the JOA in the totality of the rights and obligations which are derived from the concession.<sup>6</sup> The PIs which apply to the parties at the outset of a JOA will be the product of a negotiation between those parties.

A fair legal analogy is to suggest that if the interests of the parties in the concession are held as joint tenants (being a collective, unitary interest where each joint tenant is entitled to possession of the whole of an interest which is the subject of co-ownership between a group of parties),<sup>7</sup> then the parties sever that joint tenancy through their entry into the JOA, where the interests of the parties in the JOA will be held as tenants in common (being a separate, undivided interest where each tenant in common is entitled to a distinct share in the whole which is commensurate with its defined PI).<sup>8</sup> Indeed, the CAPL JOA declares<sup>9</sup> that the parties

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6 AIPN JOA §§1.48, 3.3(A); OGUK JOA §4.

7 *Burton v Camden LBC* [2000] 2 AC 399.

8 *Cowcher v Cowcher* [1972] 1 WLR 425.

9 CAPL JOA §1.05A.

intend that their interests in the joint lands and in the joint property will be held as tenants in common.

A party's PI will define several items under the JOA,<sup>10</sup> notably:

- that party's required percentage contribution to the operator's cashcalls or invoice requests (16.2) and to the costs associated generally with the JOA (which could, however, be qualified by a carried interest (see below) or in accordance with the terms of a farm-out agreement (see Appendix C));
- the percentage interest which that party has in the joint property (4.1) and the party's entitlement to produced petroleum (9.1); and
- that party's share in the liabilities incurred under the JOA (see Chapter 12).

The parties' PIs will apply in respect of the joint operations. Where the JOA permits exclusive operations, those exclusive operations will recite their own, individual PIs as between the participating parties (5.2).

The point made previously about identifying the parties over the lifetime of the JOA (see above) could be made equally in respect of tracking changes to the PIs, and similarly therefore the PIs of the parties from time to time might be recited in a schedule to the JOA, with a requirement for the operator to revise the schedule and to distribute the revised schedule to all the parties in the event of any changes to the PIs. This change might also be recited through a combined novation and amendment agreement (17.3).

Where the JOA is constituted by several parties, each with its own individual PI, then it may be that one of the parties undertakes a programme of buying out the interests of the other parties as the opportunities to do so arise. This activity will increase the aggregate PI of the acquiring party and will reduce the number of the parties in total. Taken to the extreme, this process of consolidation will result in there being one party to the concession, with a PI of 100%. The effect of this process of aggregation on the voting control regime in the JOA (7.4) should be appreciated.

In the context of North American leasehold interests (1.5), the manner in which the PI of the parties is determined will necessarily be different according to the different constitutional basis for such a JOA.

Thus, taking the example of the AAPL JOA by way of illustration, under AAPL JOA 610 each party will bear the costs of the joint operations and will own the produced petroleum according to the ratio of its defined leasehold interests<sup>11</sup> (but the term 'participating interests' or 'percentage interests' is not actually used to describe such allocation). Under AAPL JOA 710, each party is expressed to have a 'participating interest', which is defined as the percentage of the costs and the risks of undertaking an operation which a party agrees to bear.<sup>12</sup> Under AAPL JOA 810, each party will have what is defined as a 'participating interest share', which is in turn defined as the proportion (expressed as a percentage) which the leasehold interests of that party which have been pooled in the JOA bears to the leasehold

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10 OGUJ JOA §21.1

11 AAPL JOA 610 §III B.

12 AAPL JOA 710 §§2.29, 8.1.

interests of all the parties which have been so pooled in the JOA (unless all of the parties agree to another basis for determining their participating interest shares),<sup>13</sup> and all rights, obligations, property and petroleum will be owned by the parties according to their respective participating interest shares.<sup>14</sup>

Similar provisions apply in respect of the CAPL JOA, wherein a 'working interest' is defined for each party as each party's percentage undivided working interest in the defined joint lands.<sup>15</sup>

Despite these differences in the manner of determination of a party's interest in the JOA, however, the result will be much the same as the manner of determination of a party's PI as outlined above – the parties will agree to allocate the costs and the benefits which are associated with the joint operations between themselves, according to certain predefined percentage shares.

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13 AAPL JOA 810 §2.51.

14 AAPL JOA 810 §1.2.

15 CAPL JOA §1.01.