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EDITOR'S NOTE: YES, DATA CENTERS

Victoria Prussen Spears

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Raeesa Hoosen, LLB. at (1908) 673-3323
Email: raeesa.hoosen@lexisnexis.co.za

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Anatomy of a Joint Operating Agreement

*By Simon Collier and Scott Loader**

In this article, the authors discuss joint operating agreements, which are important to the success of upstream oil and gas projects.

Few contracts are more important to the success of an upstream oil and gas project than the Joint Operating Agreement (JOA). While the concession, production sharing contract, licence, or lease establishes the relationship with the host state, the JOA governs the relationship among the companies that must work together to find, develop, and produce the hydrocarbons. It is, in effect, the internal constitution of the venture.

A JOA determines who will operate the asset, what authority that operator will have, how work programmes and budgets will be approved, how costs and production will be shared, what happens if a party elects not to participate in a proposed operation, and what remedies are available if one participant fails to meet its obligations. It also addresses transfers of interests, confidentiality, insurance, liability allocation, decommissioning, and dispute resolution.

Although there is no “market standard” JOA, the Association of International Energy Negotiators (AIEN) JOA is perhaps the most widely used and accepted form of JOA. In this article, we have therefore used the AIEN 2023 Model International JOA (the AIEN JOA) as a reference point. Although terms will vary by jurisdiction, project type, and bargaining power, most JOAs are built around a stable set of core provisions and recurring negotiation issues, which are discussed below.

PURPOSE: ENABLING JOINT ACTION

The practical purpose of a JOA is to let multiple owners act through a single operator, while retaining agreed rights of supervision and protection for all parties. To do so, the agreement performs several functions at once. It:

- appoints the operator and defines the operator’s powers;
- establishes an operating or management committee through which non-operators exercise oversight;
- sets voting thresholds for different categories of decisions;
- allocates participating interests and cost-bearing percentages;
- creates procedures for annual work programmes, budgets, authority for

* The authors, attorneys with Hunton Andrews Kurth LLP, may be contacted at scollier@hunton.com and sloader@hunton.com, respectively.

expenditure approvals, and emergency spending; and

- addresses sole risk and non-consent operations, defaults and remedies, audit rights, transfer restrictions, confidentiality, liability, insurance, and dispute resolution.

OPERATORSHIP

One party, the operator, will be appointed to conduct petroleum operations on behalf of all participants. The operator is responsible for the day-to-day execution of operations, proposing programmes and budgets, managing drilling and production activity, contracting with suppliers, maintaining records, submitting cash calls, and usually acting as the operational face of the venture.

The operator is generally not entitled to a fee for performing the role but will be entitled to recover its costs, which can itself be the subject of intense debate where costs are incurred by the operator at a group level (e.g., IT or HR costs are usually centralised within a large corporate group) and allocated to the venture. The role of operator is nonetheless often seen as highly desirable by companies with the capacity to perform it, as the operator has a level of control over the venture that far exceeds any non-operator. Non-operators effectively have an oversight and funding role only.

As the role of the operator is so fundamental to the operation of a highly valuable asset, the rights and obligations of the operator are potentially the most important and heavily negotiated in the agreement. These provisions generally deal with appointment, resignation, removal, replacement, standard of care, limits on authority, use of affiliates, and the operator's liability standard. Operators seek enough discretion to manage operations efficiently and to avoid second-guessing after the event. Non-operators seek visibility, accountability, and constraints on unilateral action.

One especially important area is the standard by which the operator must perform its duties. For example, Article 4 of the AIEN JOA requires the operator to act in accordance with the underlying concession contract, applicable laws, the JOA, approved work programmes and budgets, and operating committee decisions that do not conflict with the agreement. The same article also requires the operator to conduct joint operations in a diligent, safe, and efficient manner in accordance with good and prudent petroleum industry practices and field conservation principles generally followed by the international petroleum industry under similar circumstances.

THE OPERATING COMMITTEE

If the operator is the executive arm of the venture, the operating or management committee is its governing body. This is where non-operators seek

to exercise influence and where key strategic, technical, and financial decisions are made.

The committee provisions typically address composition, voting rights, quorum, meeting procedures, emergency decisions, reserved matters, and deadlock. Although these clauses can appear procedural, they often cause significant commercial negotiation, as they can determine who can block, delay, or force a decision affecting all parties involved.

Routine matters may be approved by simple majority or by virtue of an already approved budget. Major decisions typically require supermajority support, either through a specific number of JOA parties or those parties representing a minimum percentage of the overall participating interest giving approval, and a smaller category may require unanimity. The challenge is to calibrate these thresholds so that the venture remains governable without exposing minority parties to unacceptable risk.

WORK PROGRAMMES, BUDGETS, AND AFEs

Most JOAs require the operator to prepare and submit a proposed annual work programme and budget, together with supporting detail and, where appropriate, authority for expenditure (AFE) requests for specific operations (usually tied to a threshold of expenditure). The committee then reviews, approves, amends, or rejects the proposal within a specified timetable. The JOA will also deal with supplemental budgets, cost overruns, emergency expenditure, and the consequences of failing to approve a budget before the beginning of the relevant period.

Ultimately, the approach taken in a JOA will depend on the commercial agreement between the parties, meaning approaches can vary. The balance that must be struck is one of allowing the operator enough budget discretion to prevent unnecessary delay in the conduct of petroleum operations, while not granting so much discretion as to commit the venture to expenditure levels that other parties consider excessive. It is for this reason that JOAs tend to establish clear expenditure thresholds, require committee approval for material deviations from approved budgets, and preserve emergency spending authority only for genuine safety, environmental, legal, or asset-preservation situations.

Whether or not an AFE is required by the operator for expenditure within an approved budget can vary. The AIEN JOA allows one alternative in which AFEs are required above stated dollar thresholds for exploration, development, production, and decommissioning operations (a commonly adopted approach), and another in which no AFEs are required for expenditure within approved budgets and only supplemental expenditure information is provided. It also includes an optional variant under which AFEs are for information only and another under which they require operating committee approval.

SOLE RISK AND OPERATIONS BY FEWER THAN ALL PARTIES

The basic rationale behind sole risk operations is straightforward; one participant should not always be able to veto a commercially attractive operation simply by withholding support. Equally, unwilling parties should not automatically be forced to fund every proposed activity. The sole risk mechanism attempts to reconcile these principles by allowing consenting parties, in defined circumstances, to proceed at their own cost and risk while granting them an enhanced return if the operation succeeds.

A JOA should include provisions setting out who may propose an exclusive operation, who carries cost and liability, how joint property may be used, and what economic premium applies to later participation for those parties that elected to opt out initially.

CASH CALLS, ACCOUNTING, AND DEFAULT

The JOA usually requires the operator to issue advance cash calls for estimated expenditure, followed by billing statements and final accounting. It will specify payment periods, interest on late amounts, accounting procedures, currency treatment, exchange rate mechanics, and audit rights for non-operators. In international practice, these provisions are often supported by a detailed accounting procedure attached as a schedule.

Disputes in this area are common and often recurring. Non-operators may challenge whether costs were properly incurred, whether affiliate charges are arm's length, whether procurement procedures were followed, or whether overheads were correctly classified. Operators, for their part, may object to prolonged audit objections and delayed close-out of historic accounts.

A key consideration of the JOA is to anticipate the failure of the parties to meet their payment obligations. In capital-intensive projects, a default by one participant can disrupt operations, place pressure on the others to bridge funding gaps, and create immediate commercial and legal uncertainty. The agreement therefore needs an effective regime for dealing with payment default, material breach, and insolvency.

In the event of a party's default, it is usual for the JOA to restrict the actions and rights of the defaulting party. For example, Article 8 of the AIEN JOA provides various options as to the consequences for a party being in default, including:

- losing its right to call or attend operating committee meetings, or vote on any matters coming before such committee;
- having access to any data or information relating to operations under the JOA;

- consenting to or rejecting data trades between the parties to the JOA and third parties, nor access to any data received in such data trades;
- receiving its entitlement of hydrocarbons under the JOA;
- taking assignment of any portion of another party's participating interest if such other party is in default or withdraws from the JOA;
- being prevented from transferring its participating interest to any party except a non-defaulting party; and
- in the event of prolonged default, being required to withdraw from the JOA and transfer its participating interest to a non-defaulting party.

TRANSFERS AND CHANGES IN CONTROL

JOAs usually include provisions restricting assignments, granting pre-emption rights in favour of existing parties and in some cases the NOC or other governmental entities, imposing financial and technical capability standards on proposed transferees, and addressing the continuing liability of the transferor.

These provisions are necessary, due to the long-term nature of a JOA. The identity and capability of the JOA partners are important to all members; a technically weak, undercapitalised, or politically problematic transferee can increase risk for everyone in the venture.

It is important for the JOA to address not only direct transfers of interests but also to consider a change in control of a party. Article 12 of the AIEN JOA addresses both transfers and changes in control as distinct subjects. Many JOAs fail to do this, meaning that a transfer at a corporate level rather than at an asset level can avoid key restrictions, including pre-emption rights.

DECOMMISSIONING: FROM END-OF-LIFE ISSUE TO FRONT-END DRAFTING TOPIC

Decommissioning has become a more prevalent and heavily discussed topic in the oil and gas sector as a whole, with decommissioning no longer being treated merely as an end-of-life issue. As a result, it is increasingly prominent in JOA discussions.

The AIEN JOA includes a comprehensive article (Article 10) on decommissioning and abandonment, a decommissioning work programme and budget provision in Article 6.5, and a detailed Exhibit E dealing with decommissioning procedures, cost estimation, trigger dates, funding, security, surplus, and audit.

The AIEN JOA also includes alternative methodologies for determining the trigger date for contributions to a decommissioning trust or escrow fund, including a net-value test and a reserves-based test; requires annual decommissioning cost estimates and forecasts; and permits either operator good-faith estimates or estimates prepared by an independent consultant.

CONCLUSION

A JOA is often described as a standard industry document, but that description can be misleading. While model forms (such as the AIEN JOA) provide a useful starting point, no JOA is routine and each must be carefully drafted and negotiated on a case-by-case basis. A well-drafted JOA creates a workable balance between operational efficiency, fair risk allocation, strategic protection and legal certainty.