

Abdulkarim ALTHIYABI¹

The impact of sole-risk and non-consent clauses on Joint Operating Agreements in petroleum fields. A critical analysis

ABSTRACT: Joint Operating Agreements (JOAs) play a pivotal role in facilitating the exploration and development of oil fields across various jurisdictions by allowing multiple parties to collaborate and share resources. However, differing perspectives and priorities among JOA participants can lead to disputes and operational inefficiencies. To ensure smooth operations and prevent potential conflicts, it is crucial that JOAs are precisely drafted and clearly define the scope and limits of joint activities. This paper examines the practical implications of sole-risk and non-consent clauses in JOAs, which aim to regulate unilateral actions by individual parties and maintain the collaborative spirit of the agreement. Sole-risk and non-consent clauses can effectively prevent disputes by specifying the boundaries of joint operations and individual party responsibilities. They ensure that parties do not extend the scope of the JOA to activities that are meant to be conducted independently, thereby preserving the agreement's original intent. Nevertheless, these clauses must be narrowly defined in order to avoid inadvertently restricting the flexibility and collaboration that are the hallmarks of JOAs. This study analyzes various cases in which sole-risk and non-consent clauses have been implemented and evaluates their effectiveness in preventing disputes and promoting efficient joint operations. The findings reveal that when carefully drafted and unambiguously defined, these clauses can be advantageous in maintaining harmony and cooperation among JOA parties. It is evident

✉ Corresponding Author: Abdulkarim Althiyabi; e-mail: Asalthiyabi@ut.edu.sa

¹ Law Department, University of Tabuk, Saudi Arabia; ORCID iD: 0000-0001-6255-0794; e-mail: Asalthiyabi@ut.edu.sa



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that striking a balance between protecting individual interests and fostering collaborative endeavors in oil-field exploration and development is essential for the successful implementation of sole risk and no consent clauses within JOAs.

KEYWORDS: Joint Operating Agreements (JOAs), sole-risk clauses, non-consent clauses, oil-field exploration

Introduction

The Joint Operating Agreement (JOA) forms the foundation for conducting joint activities on behalf of the participating parties. As one of the most commonly used agreements in the oil and gas sector, it is essential that the JOA precisely defines the scope of joint operations. Various standardized forms of JOAs currently exist, providing parties with the flexibility to choose and modify the agreements to suit their specific needs. This paper raises the question of the effect of sole-risk and non-consent provisions under the JOA in instances where a party or a group of parties does not support particular decisions or interests. Addressing this issue is crucial for all parties involved in order to avoid potential disputes at the outset of the JOA. Failure to do so may lead to subsequent disputes, which can prove to be disruptive to the JOA and potentially result in its termination. The paper will first consider the process of forming the JOA and its application within the petroleum field. Next, it will analyze the effect of the sole-risk and non-consent clauses and assess whether they offer any advantage to the oil and gas industry. Lastly, a practical examination of two important cases that have dealt with both provisions and the controversies surrounding them will be conducted, offering valuable insights into the practical implications of these clauses. By thoroughly examining these aspects, the paper provides a comprehensive understanding of the role and impact of sole-risk and non-consent provisions within the context of Joint Operating Agreements in the oil and gas field.

1. Joint Operating Agreements

A Joint Operating Agreement (JOA) is a contractual framework between two or more businesses under which they agree to conduct their petroleum operations. This kind of agreement forms an alliance similar to marriage between the parties, in which the parties enter into an agreement to work toward a joint aim (Alramahi 2013). However, unlike marriage, the parties to the JOA set certain rules of conduct to be followed by the parties in the due course of their relationship. The JOA parties will be acting in concert and sharing risk towards a joint goal of sharing profit

from the joint petroleum operation (Aramahi 2013). The parties' cooperation will be governed by a framework of a jointly-owned authorization that targets the production of oil and gas to the mutual commercial advantage of the parties. This cooperation will begin with the exploration of petroleum and ends when the operator delivers each party's share of the petroleum, which is owned by all parties under the rules of the license granted. This cooperation between the participants tends to lower the cost of the oil and gas operation and increase competencies and profits. The mutual interests of the parties are therefore reflected in the JOA draft, which obliges the parties to work together but separately and distinctly (Penman and Christopher 1993).

1.1. Government approval

Before the JOA comes into effect, it must receive government approval from the Department of Energy and Climate Change (DECC). It is a notable fact that the UK Continental Shelf is a "mature province" (Gordon et al. 2017). This has resulted in the oil and gas industry within the United Kingdom Continental Shelf (UKCS) encountering increasing challenges with respect to project execution, culminating in the use of a larger number of independent oil and gas operating businesses (Penman and Christopher 1993). To address these challenges, the industry has capitalized on and pooled its resources through the JOA, sharing the capital required to fund project operations (Taverne 1994). In the UK, this is done by providing a license to a group of licensees for the purpose of minimizing costs, sharing risks, and maximizing profits (Penman and Christopher 1993). The creation of the JOA normally entails the apportionment of at least some of the rights provided under the Petroleum Act license. Therefore, it needs the consent of the Secretary of State, who is empowered by the Petroleum Act 1998 to approve the creation, novation, and amendment of the JOA in respect to the parties' entitlement to it. To avoid unnecessary delays, consent is currently provided in the form of open permission, which gives prior approval to most instances of creation, novation, or amendment of the parties' JOA, provided that it does not grant rights outside the license's scope or assign rights to non-approved operators (Aramahi 2013).

1.2. Joint Operating Agreement participants

The JOA governs the relationship between the parties and creates a tenancy in common between them concerning the authorization, as they will be jointly liable to the government for any breach of the license obligations. The JOA also allocates the participants' shares in the project, which does not have to be even, as it will depend on each party's initial contribution to the project, consequently reflecting its share (Penman and Christopher 1993). Furthermore, the JOA participants are classified as being either an operator or a non-operator. The operator is the participant who undertakes responsibility for the day-to-day management of the petroleum operations

(Gordon et al. 2007). It is typically the party with the largest share in the JOA and is in possession of the required technological expertise (Taverne 1994). The operator must be nominated by the non-operators but must also be approved by DECC, and their removal must be approved by the same. Moreover, the operator is obliged to conduct the JOA in conformity with the license and any applicable laws in this regard. It must also conduct the JOA in a way that meets certain prescribed degrees of competence. That being said, the operator should neither gain profit nor suffer loss as a direct result of acting as such; however, this could be overturned if the parties insert an express provision in the JOA stating the contrary (Alramahi 2013).

Furthermore, apart from the control it has over the day-to-day operations, the operator shall only carry liability up to its percentage share in the JOA. The operator will not be liable for an honest mistake or misjudgment; however, it will be liable for willful misconduct. Even if the operator is found to be liable for willful misconduct, it will not be accountable for consequential loss. The operator removal provision is contained in all JOAs, which permits the removal of the operator in the event of willful misconduct, committing a material breach, or failing to perform a material obligation on its part as stated in the JOA.

The different duties and operations of the participants in the JOA can be clearly understood by examining the non-operator rights and duties. The most important duty of a non-operator is to provide a share of the funds whenever there is a cash call. However, they are to be considered as active investors, and therefore, they can have an active say in the management of the JOA through the Joint Operation Committee (JOC) (Gordon et al. 2007). In some JOAs, the whole responsibility for the management of the JOA is assigned to the JOC. This committee involves representatives of all parties to the JOA, aiming to supervise and control all issues associated with the joint operation (Taylor et al. 1992). The committee reaches a decision through the voting procedure specified in the JOA (Daintith and Willoughby 1984). The voting is normally a reflection of each party's percentage interest in the JOA, and it is to be affected by the pass mark, which is to be negotiated by the participants depending on their contractual strength (Gordon et al. 2007).

1.3. Voting procedure

One of the most significant issues dealt with by the Joint Operating Agreement is the decision-making process (Alramahi 2013). As stated earlier, the Joint Operating Committee (JOC) makes decisions through a voting procedure in which a required pass mark is reached. This pass mark is pre-negotiated and agreed upon by the participants in their JOA. The voting procedure is important since it determines each of the participants' percentage under which the pass mark is reached (Daintith et al. 1984). Normally, the party with the larger share tends to ask for a high pass mark in order to be able to approve or veto any decision. On the other hand, participants with small shares seek some protection against the risk of one or two participants forcing an action to be taken or avoided. This matter is very sensitive to the parties, and therefore, some forms of JOA have attempted to solve this issue (Martyn 1996). For instance, a series of alternatives have been

provided in the Association of International Petroleum Negotiators (AIPN) JOA voting procedure, where it includes a provision stating that the JOC decisions are to be effective when the pass mark has been reached by the vote of a specific number of participants (Clause 5.9). During the voting procedure, the sole risk and non-consent clauses come into play, as different participants have various commercial perspectives (Aramahi 2013).

2. Exclusive operations

The Joint Operating Agreement (JOA) is intended to be a method where certain decisions and undertakings are jointly reached by all participants. This assumption goes to the root of the JOA; however, during the lifetime of the JOA, the participants' interests might not be compatible, and therefore, a certain party or parties might not wish to conduct a particular joint operation (Penman and Christopher 1993). This is evidenced in the voting procedure where one or more parties' proposed interest fails to reach the required pass mark and consequently, they choose to proceed with the project on their own under the sole-risk provision. Alternatively, those parties might vote against a proposed project which they see not in their best interest, but the project still reaches the required pass mark. In this situation, the parties who wish not to participate in the majority-approved project might seek to opt out by relying on the non-consent clause (Caddie 2004). The main purpose behind such clauses is to enable those participants who wish to begin a certain project to do so without dissenters. It also enables participants to conduct projects on their sole risk in case of any disagreement between the parties about an important policy decision. At this stage, it is essential to undertake a detailed examination of both clauses with a particular focus on the perceived and the actual differences between them.

2.1. Sole-Risk and Non-Consent Clauses

The first clause provides that when a project has failed to be approved by the Operating Committee (OPCOM) for not obtaining the required pass mark, the members in favor of such projects might nevertheless continue with this project. It is usually included in a joint venture (JV) that if the sole risk provision is successful, then the non-participating parties will be able to buy back into the share of the production upon paying a substantial premium (Penman and Christopher 1993). This premium is normally ten times the amount of earlier payment and seeks to act as a deterrent against the exercise of sole risk clauses. The sole risk clauses are applicable to four distinct stages of activities: seismic, drilling, testing, and development of petroleum projects (OGUK JOA 2023). This provision, being different from the participants' mutual interest, will form a distinct area of the venture and thus redefine the venture's scope. Since every petroleum

project developed by the sole risk parties will amount to a co-venture, it belongs only to the sole risk participants. The effect of this provision is that all costs and entitlement resulting from the project rest exclusively on the sole risk participants (Daintith and Willoughby 1984).

The non-consent clause is contrary to the sole-risk clause since it comes into existence when the proposal receives the required vote, but the outvoted dissenters wish not to participate in this proposed project. In such cases, if the JOA contains a non-consent clause, then those reluctant participants might choose not to participate, thus reducing the proposed project participants to those who chose to join in the project. This clause seems to be desirable by participants with limited financial resources or those who might see a better investment in another proposed project (Roberts 2012). Also, those participants who wish to avoid the risk associated with the proposed project because they are not satisfied about its potential and may not want to be dragged into a project which they may see as not in their best interests (Aramahi 2013). However, it is argued that the non-consent clause could be seen as contradictory to the basis of the joint venture the majority decides upon, and if the door is always open for dissenters to opt out, then this might make the process of voting worthless.

The common link between the sole risk and non-consent clauses is that they both begin their journey as a proposal to the OPCOM for the joint performance of a certain project. In spite of the efforts that are usually taken in negotiating or applying the JOA with regard to the sole risk and non-consent clauses, both clauses involve an operation that is taken by less than all participants. There might be a situation where the operation could be classified as both sole-risk and non-consent operations (Roberts 2012). Furthermore, the Association of International Petroleum Negotiators (AIPN) JOA has provided an exclusive operations provision under which a party can propose a project to the other participants, and if it is rejected, they may proceed with it on their own as an exclusive operation (AIPN JOA 2012). This is effectively a case of both sole-risk and non-consent clauses since if the party chooses not to join the proposal, they will be exercising their non-consent right. At the same time, the party making the proposition, if they choose to continue despite the lack of support from the other parties, will be doing so at their sole risk.

The Canadian Association of Petroleum Landmen (CAPL) JOA provides a similar clause, recognized as independent operations, in Clause 10.4. Under this clause, any party can notify the other parties of its intention to conduct a particular project; it is then up to the parties to choose whether to participate in this project (Roberts 2012). This goes beyond the AIPN provision since the mechanism can be relied upon by the operator to propose a joint project to be taken by all participants, but still subject to both sole-risk and non-consent clauses. It is notable that every JOA will contain clauses of sole risk and non-consent clauses since they are universally recognized in the negotiation of JOAs. Even if they do exist, their application is tough in practice (Roberts 2012).

2.2. The effect of the sole risk and non-consent clauses

When incorporating clauses for exclusive operation in a Joint Operating Agreement (JOA), certain practical issues should be considered. These practical issues apply equally to both sole risk and non-consent clauses, unless stated otherwise.

2.3. Types of operation

The JOA may delineate specific types of operations that can be conducted by fewer than all participants, thereby prohibiting any exclusive operation that might conflict with an already approved joint operation (AIPN JOA 2012; OGUK JOA 2023). Sole-risk operations will be restricted to works that are non-obligatory under the relevant license, as they only apply to works exceeding the minimum requirements. This is because JOA participants must have agreed to contribute their share towards the minimum work requirements to maintain the license in good standing. This principle was exemplified in the Ithaca case, where provisions 14(2) and 14(3) of the parties' JOA imposed two constraints on the applicability of sole risk drilling (Ithaca Energy (UK) Ltd v North Sea Energy (UK) Ltd 2012). However, the inapplicability of sole risk to obligatory works is only effective where the nature of such undertakings is explicitly stated in the conditions accompanying the grant of the relevant license, which is a circumstance that seldom occurs (Penman and Christopher 1993). In fact, Nicholls provides a definition for an obligatory well, suggesting that selecting an incorrect interpretation risks license cancellation and potentially encourages operations conducted exclusively through the voting pass mark, with any failure regulated by default rules in the JOA (Nicholls 1981). Moreover, relying on non-consent clauses for high-cost operations could impose a disproportionately excessive financial burden on participating parties, potentially leading to a term in the JOA prohibiting the application of non-consent clauses for specific major expenditure items (Roberts 2012).

The type of well to which sole risk applies holds great importance, as early-stage work is generally more conducive to exercising a sole risk operation. Defining an exploratory well, the most common sole risk activity, can be challenging. The JOA should include a clear definition of an exploratory well, which is typically determined based on the most recent date and information at the time of spudding the well. Sole risk could also extend to appraisal wells, which assess the extent of a discovery. However, this is quite rare in well-drilling development as such operations typically fall under the purview of JV activity. In this context, all participants are obligated to follow the majority vote, with the option to opt in or out of the overall development at the outset, after which there is no room for withdrawal until the completion of the capital investment (Moroney 1986).

Furthermore, Saville identifies two situations in which sole-risk development activity should be permitted: (a) when the proposed development fails to secure the requisite voting percentage, sole risk can be exercised over the entire development, provided it does not disrupt joint acti-

vities; (b) a party should also be allowed to exercise sole risk in the development of a project, regardless of majority approval, if they have already sole risked the exploration and appraisal well (Saville 1986). That being said, the development proposal should still be presented to the other JOA participants who might want to join (Penman and Christopher 1993). In such a situation, the development decision in the absence of a unanimous agreement to proceed should be based on an independently conducted feasibility study rather than a majority vote, which might prevent sole risk participants from reaping the benefits of their discovery (Waite 1986). The competing interests of parties involved in the primary work of a specific well, or in a field where the well is situated, underscore the complexity of allowing a sole risk operation beyond the exploration phase (Penman and Christopher 1993). Consequently, the challenge confronting drafters lies in the capacity to accurately pinpoint the distinct rewards derived from a successful sole-risk endeavor, and to harmonize the competing interests in oil or gas extraction from the particular field among the joint venture (JV) parties, including those who have engaged in sole-risk or non-consent activities (Ryan 1983).

2.4. Allocation of costs and profits

The JOA will stipulate that the costs associated with executing an exclusive operation fall upon the participating parties and the rewards derived from such exclusive operations should correspondingly be allocated in favor of the same participants. The exclusive operation is distinct in that it provides rewards and imposes expenses on those who have elected to participate, while non-participating parties are exempt from contributions and are not entitled to any benefits (AIPN JOA 2012; OGUK JOA 2023). Therefore, the exclusive operations interest should be drafted in a manner that avoids confusion with the general interest under the JOA. The allocation of costs and profits among the participants of an exclusive operation may be conducted based on any agreed-upon principles or in compliance with a formula wherein the original personal interest of each participant is proportional to the aggregate of the personal interests of all exclusive operation participants (AIPN JOA 2012; OGUK JOA 2023). It is worth noting that if a participating party defaults in meeting a cash call or invoice request related to an exclusive operation, it should lead to defaulting remedies undertaken by the other participants that would adversely affect the defaulting party's interest in the exclusive operation but not the broader interest under the JOA. Although this assertion appears straightforward in theory, the practical implementation of forfeiting the defaulting participant's interests in both the concession and JOA presents significant challenges (Roberts 2012).

2.5. Relation with JV operations

Sole-risk activities transpire within the overarching context of a petroleum joint venture (JV) and as such, the outcomes of these operations inherently interact with the respective rights and duties of all participants under the petroleum JV (Penman and Christopher 1993). This interaction gives rise to several issues, which will be discussed below.

The first issue concerns ensuring that the sole-risk program does not interfere with joint operations. The JOA should prohibit sole-risk programs if they impede ongoing or proposed joint venture activities. This consideration is especially pertinent when the project area is relatively small, barely accommodating the approved joint operation agreements. However, sole-risk operations can be highly beneficial when the area is expansive and the remaining license period is short, as this encourages greater diversity and expedites the exploration process. Drafting some JOAs with provisions stipulating a minimum distance between joint operation activities and those falling under sole risk largely mitigates this interference issue (Penman and Christopher 1993).

The second issue revolves around the ambiguity surrounding the operator's role and whether the operator will oversee the sole risk activity if it exercises its right of non-consent as a participant to the JOA. Typically, JOAs leave the decision to the operator, who will generally accept the role if they are a party to the sole risk operation. If the operator chooses not to assume this responsibility, especially when not a party to the sole-risk operation, the sole-risk participants must elect another operator (Ibid). In any case, this alternate operator must be a participant in the JOA, ensuring contractual recourse for all parties. Given that JOA provisions prohibit sole-risk operators from seeking contributions from non-participants, even in cases of default under the sole-risk operation, the operator under the JOA may be reluctant to assume this responsibility (Penman and Christopher 1993). It is crucial that the operator's decision takes into account the financial capacity of the proposed sole-risk parties and its own assessment of the sole-risk program. Operators under the JOA must carefully evaluate their obligations before assuming additional responsibilities. The sole-risk operator must also maintain separate books and records from those pertaining to joint operations (Ryan 1983).

The third issue pertains to the indemnification of non-participating parties by sole-risk participants concerning any loss resulting from the sole-risk program. Participants in an exclusive operation must fully indemnify non-participating parties for any losses they incur due to the exclusive operation. This requirement arises from the possibility of non-participants facing claims concerning torts committed, contracts entered into by the operator exceeding its authority, or breaches of exploration license terms. The fact that indemnification for consequential losses is a matter of negotiation raises certain arguments. Some argue that excluding consequential losses is fairer, aligning with the broader liability regime under the JOA and how it considers such losses. Conversely, others contend that indemnification is more equitable as non-participants may suffer losses through no fault or participation of their own (AAPL JOA 2007). The latter argument seems more reasonable regarding sole-risk activities, as sole-risk participants should be responsible for their own faults. However, it is also argued that non-consent participants should not be protected from consequential losses, as they had the option not to participate and would

have been liable if the JOA did not include the non-consent clause option, thereby compelling them to participate (Roberts 2012).

This indemnity requirement may lead to extreme situations, such as when the manner in which the sole risk operation is conducted results in the concession's revocation by the government. In this case, the question of the extent of participants' liabilities for consequential loss to non-participants arises, as the liability could be enormous and potentially unbearable for participants (Roberts 2012). This complex area is rarely addressed, as most JOAs neglect to consider such hypothetical scenarios, which could carry significant consequences. This omission may be due to the clear drafting of exclusive operation scopes, which outline what they should and should not cover, thereby avoiding unexpected outcomes arising from these activities.

Another crucial issue to examine is the extent to which parties involved in an exclusive activity can access property and materials utilized in performing joint operations (Roberts 2012). The JOA may permit exclusive operation participants to access such resources, provided that doing so does not negatively impact upon the performance of joint operations. Access could be granted conditionally upon payment by participating parties to all parties of the JOA, adhering to a fair compensation measure. This payment includes compensation from exclusive operation participants relative to their personal interests in the joint activity (AAPL JOA 2007; AIPN 2012; CAPL JOA 2016; OGUK JOA 2023). The exact compensation amount should not be prescribed in the JOA but instead left to the OPCOM to determine at the appropriate time. This approach warrants caution, as non-participant parties may be tempted to exploit this as a profit-making opportunity. Furthermore, non-participant parties may desire access to specific geological, geophysical, and other data generated by exclusive operation participants to make more informed decisions about exercising buyback rights (Roberts 2012). Consequently, it is more common for the JOA to stipulate that all participants be informed about the drilling program and its results, enabling them to decide whether to participate in future JVs arising from the sole-risk operation (Penman and Christopher 1993). In such situations, Waite (1986) suggested that if the subsequent successful development of a well relies on this data, a compensation measure should be approved at the time of conducting the work to reimburse sole-risk parties for costs incurred through data generation. This arrangement raises further complexities concerning whether the right to access data is available throughout the entire exclusive operation or limited to a defined period and whether this right applies to existing or future data (Roberts 2012). These issues are typically negotiated between JOA participants when drafting the original joint operation agreement. As such, it is essential to draft these agreements with precision and clarity in order to avoid encountering these challenges in the future.

2.6. Buy-back rights

The Joint Operating Agreement (JOA) typically provides each party that has chosen not to participate in the exclusive operation with a well-defined right to reinstate its interest in that

activity through the right of buying back in. If all non-participants exercise this right, then the exclusive activity will be reconstituted as a joint activity. Some JOAs make the exercise of this buy-back right more challenging in the situation of a non-consent election, even going so far as to preclude its applicability altogether. This is done with the intention of burdening the dissenting party indefinitely, as their initial disagreement should not be easily dismissed. By implementing this approach, the JOA aims to deter participants from exercising their non-consent right from the outset, thereby preserving the cohesion and overall stability of the JOA.

Considering the risks that exclusive operation participants undertake, it may be viewed as unfair to allow non-participating parties the chance to join when the operation proves to be successful in hindsight. Therefore, certain mechanisms have been developed and adopted by various JOAs in order to condition and regulate the buy-back rights. One such mechanism restricts the period for exercising this right, limiting it to a specific timeframe and a particular stage of development, rather than leaving it open for the entire duration of the exclusive operation (AIPN JOA 2012; OGUK JOA 2023).

Another approach to conditioning the buy-back right requires the non-participating party to pay a sum equivalent to the loss incurred by the participants in the performance of the exclusive operation. This payment effectively returns all parties involved to their original positions, as if the non-participating party had been involved from the beginning of the program. In addition to this payment, a premium may also be demanded, which could be significant, potentially reaching hundreds or even thousands of percent (AIPN JOA 2012). The non-participating party can pay this premium in various forms, such as with cash, petroleum entitlements, or by committing to cover future cash calls and invoice requests.

The concept of this premium is often viewed as a penalty imposed on the non-participating party for their initial choice not to participate in the exclusive operation (Roberts 2012). However, describing it as a penalty is excessively harsh and should be avoided. The purpose behind the JOA voting system is to respect and appreciate all parties' decisions, whether they are in agreement or dissent, while still moving forward with the majority-approved decisions of the JOA parties. Once the buy-back right is completely exercised, the original participants in the exclusive operation must account for the allocation of any commercialized petroleum during the exclusive activity period in accordance with the terms stipulated in the JOA. These petroleum allocations are made by the participants in favor of the buy-back party to the extent of the buy-back costs paid, without including any premium.

In cases where the exclusive operation has not commenced production when the buy-back occurs, the production allocation should be divided between the original and buy-back participants from the beginning. Furthermore, the JOA might include a provision under which the party's right to non-consent and to later buy-back an interest in the exclusive operation will not attract a premium. This provision applies in cases where the non-consenting party's justifications for not participating are validated by the outcome of the exclusive operation. Such a mechanism could be applied in situations where, for instance, the non-consenting party disagrees with the depth to which a well should be drilled or the potential success of such drilling. This possibility is identified as an optional provision under the AIPN JOA (AIPN JOA 2012). This optional

provision serves to create a more equitable environment for all parties involved in the JOA, as it recognizes that there may be legitimate reasons for a party's initial non-consent. By allowing for the possibility that a non-consenting party's concerns may be validated by the eventual outcome of the exclusive operation, this provision ensures that the non-consenting party is not unfairly burdened with a premium if their initial concerns prove to be well-founded.

2.7. Excluding exclusive operations

JOA participants may find solace in the assurance of comprehensive commitments from all parties concerning their involvement in joint operations endorsed by the OPCOM, precluding the possibility of a subset of participants selectively engineering their engagement in specific activities (Roberts 2012). This approach harmonizes with the foundational philosophy of joint operations, thereby circumventing the disintegration of interests. As a result, parties may elect to eliminate or substantially curtail exclusive operations within the JOA. Such limitations have been evidenced, albeit to a certain degree, in instances where the JOA renders exclusive operations nonviable, as previously delineated. The desirability of this exclusion becomes particularly salient in the context of the non-consent clause, given that a proposal securing the majority of OPCOM approval would impose a greater financial burden on participating parties. These parties would be compelled to share costs surpassing their initial personal interests if the proposal were executed by all parties as initially conceived (Roberts 2012). Consequently, the integration of such exclusions could be advantageous to JOA parties, bolstering the agreement's objectives and shielding participants from excessive expenses attributable to non-consent. The incorporation of these exclusions has the potential to enhance certainty in JOA transactions, as all parties can be confident that the voting procedure enforces participation and averts unforeseen financial repercussions.

In the realm of sole-risk activities, this issue diminishes in significance, as participants in a sole-risk program willingly assume a disproportionate share of the financial responsibility. To safeguard the integrity of bona fide joint activities under the JOA, the agreement may adopt a stringent stance, stipulating that no party shall be permitted to forgo participation in a joint operation sanctioned by the OPCOM. Nonetheless, the JOA might accommodate parties desiring to abstain from participation for justifiable reasons, such as insufficient funds or the limited potential for operational success, by incorporating a non-consent clause. Although the JOA may maintain a rigid position in relation to the prohibition of sole risk programs, certain parties perceive these programs as conferring a strategic advantage to the concession, stimulating development and innovation in petroleum activities (Roberts 2012). Moreover, during the JOA drafting process, some parties may fundamentally advocate the exclusion of exclusive activities to accentuate the principle that all endeavors should be undertaken as joint operations. This supposition is predicated on the notion that exclusive operations engender discord among parties. Paradoxically, this engenders an incongruity within the JOA relationship; all parties may endorse

reserving a non-consent clause right under the JOA to expedite an activity involving a subset of parties, notwithstanding the resultant escalation in costs. Thus, the disharmony induced by the risk of exclusive activity could prove propitious, fostering subsequent concurrence among parties (Roberts 2012).

3. The Practical Effect of the Sole-Risk and Non-Consent Clauses

Having established the theoretical foundation of the sole risk and non-consent clauses, it is crucial to conduct a practical examination of both provisions. This analysis encompasses two significant cases that addressed the effects of these provisions and the courts' rulings in resolving disputes between JOA parties. The first case was heard before English courts and primarily concerned the non-consent clause, while the second case, which pertained to the sole risk clause, was heard before the New Zealand court. The ruling in the latter case is particularly informative for the purposes of this paper as New Zealand courts are more accustomed to dealing with such clauses due to the prevalence of JOAs in that jurisdiction.

3.1. Ithaca Energy (UK) Ltd v North Sea Energy (UK) Ltd

In 2012, the English High Court adjudicated a Joint Operating Agreement (JOA) dispute between Ithaca Energy (UK) Limited and North Sea Energy (UK) Limited, centering on North Sea Energy's non-consent right with respect to appraisal drilling. The case facts reveal that the claimant (Ithaca) and the defendant (North Sea Energy "NSE"), along with Dyas UK Ltd, were participants in the development of an oil field called the Jacky Field. Ithaca and Dyas decided to jointly drill a well, to which NSE objected. The defendant argued that they were entitled to non-consent concerning their financial contribution obligation under the JOA. In contrast, the claimant contended that the drilling constituted a joint operation, obliging the defendant to contribute expenses under the terms of their Joint Operating Agreement. The crux of the case hinged on determining whether the well in question was an appraisal well. If so, the defendant could invoke the non-consent clause in the JOA to avoid contributing payment. Otherwise, the defendant would be required to contribute under the JOA terms (Ithaca Energy (UK) Ltd v North Sea Energy (UK) Ltd 2012).

The parties' Joint Operating Agreement stipulated that, contrary to the standard principle that parties shall share operation costs, a party could be exempt from this obligation if the operation conducted by the other parties fell under specific types of drilling. These drillings include "the

drilling, completion and production testing of an appraisal well inside, or the carrying out of geophysical work in respect of, the interpreted closure of any geological structure or stratigraphic trap on which a well has been drilled in which Petroleum has been found to be present” (*Ithaca Energy (UK) Ltd v North Sea Energy (UK) Ltd 2012*). Consequently, the defendant needed to convince the court that Ithaca and Dyas were engaged in such an activity to evade the obligation to contribute costs under the JOA. Mr. Justice Popplewell emphasized that the language of the JOA was sufficiently broad to encompass an appraisal well drilled into an area where production had already occurred, a point favoring the defendant as it widened the scope of defining a well as an appraisal well. To determine whether a well constituted an appraisal well, the court established a test based on the precise wording of the JOA, stating that a well “would be drilled as an appraisal well if its primary purpose, as seen by the operating committee, was to gather information and analyze it in order to inform a subsequent decision as to whether to make a further investment of funds in order to complete it as a production well” (*Ithaca Energy (UK) Ltd v North Sea Energy (UK) Ltd 2012*). Following expert testimony from both sides, the court ruled that a well could not be deemed an “appraisal well” solely due to the overall stage of the activity, and that participants might undertake appraisal operations even after DECC has considered a field development area.

In reaching its decision that the well was not an “appraisal well” within the scope of clause 14.2.2(ii)(d), the court considered the following factors: the main purpose of drilling the well, the proposal elements for drilling the well, and relevant concurrent communication between the participants. Notably, the judge rejected the notion that a well targeting contingent resources, as opposed to “reserves,” is inherently an appraisal well, and emphasized that the operating committee’s labeling is not decisive. Furthermore, it is significant to note that the drilling proposals in this situation did not envisage a pause for data analysis and its use as a factor to inform an independent decision before proceeding to complete the well as a production well, which substantially supported the judge’s decision that an appraisal well was not contemplated. As a result, the defendant was ordered to comply with the JOA terms and contribute toward the required cost, in addition to compensating the claimant for the cost of bringing the case before the court. Mr. Justice Popplewell commented on this case, stating that the court would consider the purpose of the drilling to determine whether it constituted an appraisal well. He further added that this would be decided objectively and that a subjective test would not be employed. After examining the parties’ actions, he concluded that the purpose behind the drilling was development and production and that no two-stage process of appraisal and development was envisaged (*Ithaca Energy (UK) Ltd v North Sea Energy (UK) Ltd 2012*).

This case represents a rare examination of the workings of non-consent clauses in the standard Oil and Gas UK JOA, which allow parties to opt out of certain operations. The rationale behind the court’s ruling is noteworthy, particularly the stance that the operating committee’s terminology was not conclusive, and consequently, in theory, it could lead to unforeseen outcomes. However, in this case, specific provisions of the well proposal proved invaluable in guiding the decision. Operators should bear this in mind when framing their proposals, as it will significantly impact the definition of parties’ rights and liabilities under the JOA.

3.2. Greymouth Petroleum Acquisition Company Ltd and Southern Petroleum Ltd v Ngatoro Energy Ltd

This case pertains to the Ngatoro oil and gas field, located near the town of Inglewood in the Taranaki region. In 1993, the license holders formed a joint venture (JV) for the exploration and development of petroleum in the Ngatoro license area under a joint venture operating agreement (JVOA). Subsequently, the JOA parties were granted a petroleum mining license in 1996. Through various sales, purchase transactions, and consequential assignments, the interests in the JOA were as follows: Greymouth with 59.57%, New Zealand Oil and Gas (NZOG) with 35.43%, and Ngatoro Energy Limited (NEL) with 5.0%. In February 2000, NEL proposed the drilling of an exploratory well, named Goldie, to the other joint venture parties through the JV operating committee. However, this proposal was outvoted by the majority of the operating committee. The overall scheme of the Ngatoro JVOA aimed to facilitate the participation of all parties in the exploration and development of the license area. Nevertheless, clauses for activities to be undertaken at the cost and for the benefit of only some of the parties were outlined. Eventually, NEL notified its intent to drill Goldie as a sole-risk drilling activity, as permitted under the provisions of the JVOA (*Greymouth Petroleum Acquisition Company Ltd and Southern Petroleum (Ohanga) Ltd v. Ngatoro Energy Ltd 2003*).

The drilling operation took place in February 2001, discovering both oil and gas. Goldie was immediately put into production testing, with the crude element recovered and the gas element flared. In May 2001, NEL notified its joint venture partners that it had completed its sole-risk activity. This notice activated a two-month period for other participants to decide whether to participate in the sole-risk operation. Shell opted to participate and notified NEL accordingly. According to the JVOA's provisions, NEL was entitled to a premium of six times the cost of completing the sole-risk operation. NZOG chose not to participate and consequently did not partake in the subsequent litigation. In due course, Greymouth, after purchasing Shell's interest, became a joint venture participant and the buyback participant. Greymouth then requested an operating committee meeting with NEL to address various matters, including the lack of a development plan for Goldie, the flaring of gas, the sale of gas, costs, and the participants' percentage interest in the well. NEL rejected Greymouth's motion, asking NEL as the operator to submit a development work program and budget for Goldie to the Operating Committee Meeting as soon as possible. NEL closed the meeting, which Greymouth refused to accept, assumed the chair, and voted in favor of the five resolutions. Shortly thereafter, NEL applied to The Ministry of Economic Development (MED) for a renewal of its gas-flaring consent. However, the MED maintained that flaring required the consent of all Ngatoro license holders and advised NEL accordingly. In due course, Greymouth compiled a statement of claim covering some eleven different courses of action (*Ithaca Energy (UK) Ltd v North Sea Energy (UK) Ltd 2012*).

In summary, the High Court affirmed NEL's entitlement to 100% of Goldie's petroleum revenues until it received its \$18.5 million as a premium – six times the sole risk cost. Subsequent to NEL's recovery of this amount, its share was reduced to 40% of all revenues until it recovered another NZ \$9.7 million, leading to NEL's share being 5%. The court determined that Greymo-

uth utilized its voting rights on the JV operating committee (JVOC) during the stage of making its investments. As a result, Greymouth was able to exercise its voting rights throughout the sole-risk recovery period. Moreover, the court rejected Greymouth's claim that it was entitled to a 92% interest, rather than the 60% it had purchased. The court also dismissed the claim that NEL had sub-optimally produced petroleum from Goldie, and the claim that Greymouth was entitled to Goldie by-product gas under the gas contract between the JV and Greymouth. However, the court determined that NEL had operated Goldie in material breach of its duties under the JVOA and found NEL guilty of gross negligence. The court dismissed Greymouth's claim for damages due to loss of profits but kept open the possibility of claiming exemplary damages (*Ithaca Energy (UK) Ltd v North Sea Energy (UK) Ltd 2012*).

This ruling provides some insight into the hostilities between the participants, but to truly understand the situation, one would need to delve deeper into the New Zealand oil and gas scene. In the end, the case generates little hard law but does leave the impression that a good relationship between the JVs is likely to be more significant than the wording of the JVOA. The court appears to have disregarded the wording of the JV in significant respects (*McArthur 2003*).

The cases of *Ithaca Energy (UK) Ltd v North Sea Energy (UK) Ltd* and *Greymouth Petroleum Acquisition Company Ltd and Southern Petroleum Ltd v Ngatoro Energy Ltd* demonstrate the practical effects of sole-risk and non-consent clauses in Joint Operating Agreements. These cases highlight the importance of understanding the provisions within JOAs, the significance of proper communication between the parties, and the potential consequences of disputes arising from differing interpretations of these clauses. While the specific rulings in these cases may not set any hard legal precedent, they do offer valuable insights into how courts may approach disputes involving JOAs and the related clauses, emphasizing the importance of maintaining good relationships among joint-venture partners.

Conclusion

To conclude, the Joint Operating Agreement is in fact one of the most significant agreements in the development of petroleum resources. In order to address the question raised by this paper, consideration has been made to the JOA operation and the method of electing the operator in addition to the voting procedure. Since the JOA is assumed to represent the varying interests of its parties, the sole-risk and the non-consent clauses have been developed to ensure the parties interests are met. Although these clauses have merits in developing the petroleum field as they encourage the exploration and production operations by less than all parties. It then opens the door to the other non-participating parties to buy back in and thus open the gate for the joint operation to be reconstituted. However, these clauses are also seen to be going against the main aim of the JOA, which is conducting joint operations with the participation of all parties. This joint operation is to be determined by the voting procedure since if it is to be left open for any party or

parties to assume all risk or to opt out from participating then this might have a negative impact in the operation of the granted license. It will also render the concept of joint operations that formed the basis of the JOA ineffective due to the lack of commitment between the parties. In short, it seems that the core problem with the current JOA forms is the fact that there are not many recent significant case laws dealing with the JOA issues. This resulted in solutions shaped decades ago proposing flexible remedies for inflexible issues; therefore, English courts, in contrast to New Zealand and Australian courts, seem to lack the relevant expertise in dealing with any issues resulting from the JOA. This is mainly due to the JOA being more commonly practiced in those particular jurisdictions resulting in more cases coming before courts and consequently more legal principles being introduced.

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Abdulkarim ALTHIYABI

Wpływ klauzul wyłącznego ryzyka i klauzuli braku zgody na wspólne umowy eksploatacyjne na polach naftowych. Analiza krytyczna

Streszczenie

Wspólne umowy operacyjne (JOA) odgrywają kluczową rolę w ułatwianiu poszukiwań i rozwoju pól naftowych w różnych jurysdykcjach, umożliwiając wielu stronom współpracę i dzielenie się zasobami. Jednak różne perspektywy i priorytety wśród uczestników JOA mogą prowadzić do sporów i nieefektywności operacyjnej. Aby zapewnić płynność działania i zapobiegać potencjalnym konfliktom, ważne jest, aby JOA były precyzyjnie opracowane i jasno określały zakres i granice wspólnych działań. W niniejszym artykule przeanalizowano praktyczne implikacje klauzul wyłącznego ryzyka i klauzuli braku zgody w umowach JOA, które mają na celu uregulowanie jednostronnych działań poszczególnych stron i utrzymanie ducha współpracy w umowie. Klauzule o wyłącznym ryzyku i klauzule o braku zgody mogą skutecznie zapobiegać sporom poprzez określenie granic wspólnych działań i odpowiedzialności poszczególnych stron. Zapewniają, że strony nie rozszerzają zakresu JOA na działania, które mają być prowadzone niezależnie, zachowując w ten sposób pierwotną intencję umowy. Niemniej jednak klauzule te muszą być ściśle zdefiniowane, aby uniknąć nieumyślnego ograniczenia elastyczności i współpracy, które są cechami charakterystycznymi JOA. Niniejsze badanie analizuje różne przypadki, w których wdrożono klauzule wyłącznego ryzyka i klauzule braku zgody, oraz ocenia ich skuteczność w zapobieganiu sporom i promowaniu skutecznych wspólnych operacji. Wyniki pokazują, że starannie opracowane i jednoznacznie zdefiniowane klauzule te mogą być korzystne dla utrzymania harmonii i współpracy między stronami JOA. Oczywiście jest, że znalezienie równowagi między ochroną indywidualnych interesów a wspieraniem wspólnych przedsięwzięć w zakresie eksploracji i rozwoju złóż ropy naftowej jest niezbędne do pomyślnego wdrożenia klauzul wyłącznego ryzyka i klauzuli braku zgody w ramach JOA.

SŁOWA KLUCZOWE: wspólne umowy operacyjne (JOA), klauzule wyłącznego ryzyka, klauzule braku zgody, eksploracja pól naftowych

