CHAPTER 12: MODEL FORM INTERNATIONAL OPERATING AGREEMENT: A PRACTICAL APPROACH TO DRAFTING ISSUES

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The Model Form International Operating Agreement has been written in response to inefficiency manifest in international oil and gas operating agreements. A collaborative effort of the Association of International Petroleum Negotiators and the American Corporate Counsel Association has produced the Model Form Joint Operating Agreement for the purpose of offering an agreement that can expedite negotiation time between oil and gas participants. The agreement encompasses the basic framework of standard operating agreements, but also provides standard alternative or optional provisions that can readily facilitate negotiations amongst participants working within the agreement framework. The author walks the reader through the Model Form Joint Operating Agreement, pointing out how the various provisions interact with each other and impact on operations.

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I. INTRODUCTION

For decades the international oil and gas industry has devoted substantial resources to negotiation and drafting of international operating agreements. This process often took many months and even years. Each operating agreement was an original document created from a form preferred by the operator. These forms often were not well-drafted. Many forms were similar, conveying nearly the same concepts in different language. This inefficient process has been exacerbated by an increase in international activity. As a result, the industry needed to streamline these negotiations; hence, the idea of writing a Model Form Operating Agreement was born.

A. DRAFTING PROCESS

In 1988, the Association of International Petroleum Negotiators (AIPN) and the American Corporate Counsel Association (ACCA) jointly undertook to write the Model Form Joint Operating Agreement (JOA).[1] Over the course of two years the drafting committee met seventeen times and held four general industry sessions to discuss the evolving draft. Attorneys and negotiators from nearly all the large and medium-size

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1 Model Form International Operating Agreement (New York: Barrows Company Inc., 1990).

international companies were represented in this effort. The drafters envisioned a Model Form Agreement that would capture the 75 to 80 percent of every operating agreement which is in standard, boiler-plate language, in a form that could be accepted by a broad spectrum of participants and that could facilitate the negotiation of the remaining 20 to 25 percent of the agreement using standard alternative or optional provisions activated simply by marking the spaces provided. The committee initially sought comments from AIPN members on the initial draft of the JOA; later, a questionnaire was circulated, in order to gather broad-based industry input regarding the standard concepts which would compose such a JOA. The reply to the questionnaire was overwhelming, with nearly 25 percent of the membership responding.

B. PHILOSOPHY

The JOA is based on two major philosophical concepts. First, parties are not required to accept the drafted ideas and consequences. Rather, through the use of options and alternatives, the parties can expeditiously structure a transaction to fit a wide variety of situations in line with their philosophy and in accordance with the underlying host government contract. The JOA is a flexible document that can be moulded to meet expectations and desires of the parties. Second, the JOA has been prepared to encourage exploration and development, while neither forcing a party to participate in expensive, risky ventures nor prohibiting a party from proposing and conducting ventures where the requisite operating committee passmark vote is not attained.

C. OBSTACLES

Many drafting obstacles had to be overcome, including accommodating the laws of many different jurisdictions, considering the opposing views of the operator and the nonoperator, and translating of the document into many different languages.

D. PRODUCTION-SHARING CONTRACTS

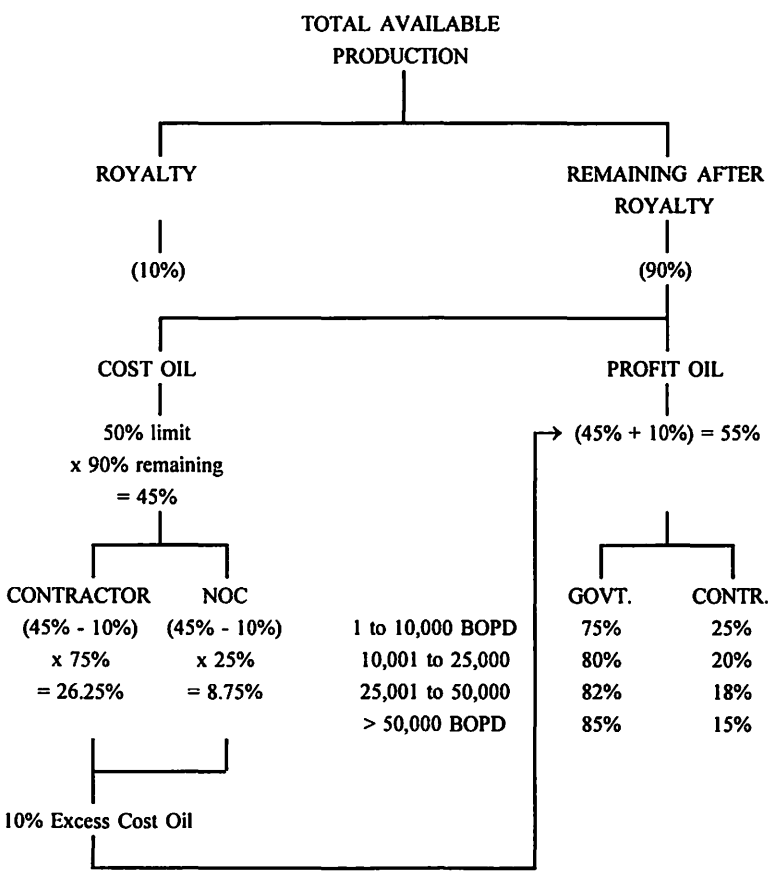
While the JOA regulates the relationship of the parties for operations under most forms of government contracts, it is particularly well-suited for use with production-sharing contracts ("PSC"). Before venturing into the terms of the JOA, we need to examine the usual structure of the PSC. The PSC, which has its foundation in the domestic United States oil and gas lease, provides the rules under which the contractor exploration companies will be permitted to explore and produce hydrocarbons within the area granted by the government. Negotiation of any PSC takes place with representatives of the ministry of hydrocarbons or their designated national oil company ("NOC"), because private ownership of mineral rights rarely exists outside of the United States, and in almost all instances the country owns the hydrocarbons. Typically, a PSC grants the contractor the exclusive right to explore for hydrocarbons in the contract area for a stated time period, but in return, the contractor is required to perform certain exploration activities, which may include seismic surveys and multiple-well programs, depending on the perceived value of the contract area at the time of the award. Once a discovery is made, the contractor, the government or both may attempt to declare it a commercial discovery, or one worthy of developing and producing.

Normally, the PSC fixes the share of hydrocarbons to which each party shall be entitled. The contractor is allowed to recoup all or a part of its costs of exploration and development from a percentage of the hydrocarbons, with the remaining proceeds being split by the contractor on a graduated basis. A typical example of the fiscal regime of a PSC is shown in Figure 1, based on the following:

Assumptions:

1) 10 percent royalty;
2) 50 percent limit on costs recovery in a calendar quarter;
3) 10 percent excess cost recovery oil falls into profit oil;
4) contractor has 75 percent equity interest in contract;
5) NOC has 25 percent equity interest in contract;
6) profit oil splits are on a graduated basis; and
7) daily production of 100,000 barrels of oil per day (BOPD).

FIGURE 1



Government share equals Royalty	10.00%		
Profit Oil	+ 46.75%	=	56.75%
NOC share equals 25% share of Cost Oil	8.75%		
25% share of Profit Oil	+ 2.06%	=	10.81%
Share of Private Parties equals Cost Oil	26.25%		
Profit Oil	+ 6.19%	=	32.44%
			100.00%

The PSC imposes other burdens on the contractor, including currency controls, customs requirements, income taxes (although such taxes are commonly paid by the government out of its share of the profit oil when the splits are as high as described above), loss of control and ownership of contractor-built facilities, and obligations to meet the domestic demands of the local markets at a reduced price. This background facilitates examination of the manner in which the JOA handles the many issues that arise in this context.

II. DEFINITIONS (ARTICLE 1)

Although the definition section is often not given appropriate consideration by drafters, it is extremely important. When amending the JOA to conform to PSC or other requirements of a given jurisdiction, the definitions section in Article 1 is the primary article for implementing changes. Throughout this article, the authors have used as many of the defined terms of the JOA as possible in order to demonstrate how the different clauses work in relation to each other. The first letter of each such defined term has been capitalized and the word set in italics to denote it as a term defined in the JOA.

A. AGREED INTEREST RATE

Rather than repeat the formula for the setting of interest throughout operating agreements, it is advisable to include the term *Agreed Interest Rate* in the definitions. The JOA provides that the interest rate be set at the current month's London Interbank Offered Rate (LIBOR) for United States dollar deposits plus a specified percentage compounded monthly. To avoid problems on ascertaining interest, the rate is the LIBOR as published in the Wall Street Journal or, if for some reason the rate is not published there, the rate published by The Financial Times of London. To avoid the concern that the number inserted is a percentage of the published rate rather than the number that is to be added to the published rate, future drafters of a revised JOA may wish to replace the reference to "percent (___%)" with "percentage points."

B. BUSINESS DAY

Business Day means a day on which the banks in a particular country, usually the host country, are customarily open for business. *Business Day* is used in the JOA to measure time periods during which action must be taken, or else the failure to take such action may be deemed to be an election of an agreed result. The insertion of the term "customarily" in Article 1.8 could cause problems where bank closings and national holidays may be dictated by the government with a minimum of notice of days on which the banks would usually be open for business. It could well be that the banks would be closed for that given day, but such day would still count as a *Business Day* for the purposes of the JOA. Also, problems may arise due to differences between the holidays in the country where notices are received or originated and the holidays of the country inserted in the JOA. It is suggested that to avoid doubt, the word "customarily" be deleted from Article 1.8.

C. COMMERCIAL DISCOVERY

Commercial Discovery under Article 1.12 means any discovery of hydrocarbons sufficient to entitle the *Parties* to apply for the authorization to begin production. It is important to determine the rights, or lack thereof, held by the contractor to declare a *Discovery* commercial under the PSC and to tailor the definition under the JOA to create the greatest flexibility for the *Parties* wishing to proceed to development. Most PSCs require a joint decision of both the country and the contractor to declare an area commercial, while others allow the contractor to simply declare an area commercial on its own notice.

D. COMPLETION

The definition of *Completion* under Article 1.13 has been hotly debated. At one extreme, *Completion* can occur when a well has been drilled and logged, and at the other extreme when it has been drilled, cased, perforated, stimulated, tested and physically connected to a pipeline or outlet so that production can be commenced with the turning of a valve or a switch. The JOA does not mandate the physical connection to a pipeline. *Completion* is defined as:

> an operation intended to complete a well through the Christmas tree as a producer of Hydrocarbons in one or more Zones, including, but not limited to, the setting of production casing, perforating, stimulating the well and production Testing conducted in such operation.

E. LIABILITY OF OPERATOR

Under most operating agreements, the *Operator* is liable for harm caused by gross negligence. Although the *Parties* frequently include a reference to gross negligence, they often disagree on the definition of the term. The JOA adopts an operator-oriented definition wherein *Gross Negligence*, under Article 1.36, means:

> any act or failure to act ... which was intended to cause, or which was in reckless disregard of or wanton indifference to, harmful consequences such Party knew, or should have known, such act or failure would have had on the safety or property of another person or entity, but shall not include any error of judgment or mistake made by such Party in the exercise in good faith of any function, authority or discretion conferred on the Party employing such under this Agreement.

A fair compromise to this language would be to delete the reference to acts or omissions made in good faith. One may simply delete the remaining language starting with "but does not include."

A related issue involves whether the *Operator* will be liable for acts or omissions of all its managers and supervisors or only for its most senior personnel. The JOA provides three alternatives:

(1) all managers and supervisors in charge of onsite drilling, construction or production operations, or any other field operations and their superiors;

(2) only the manager or supervisor of an onshore or offshore facility and his supervisors; or

(3) only the Operator's most senior resident manager.

An *Operator* will want to limit its liability to cover only the actions of its most senior personnel. On the other hand, *Nonoperators* will take the opposing viewpoint and argue that liability should reach down to lower level personnel. A more *Nonoperator*-oriented definition could easily be created with existing language: "Gross Negligence means willful misconduct or such wanton and reckless behaviour as amounts to a willful and utter disregard of avoidable and foreseeable consequences."

F. MINIMUM WORK OBLIGATION

Minimum Work Obligation means the work and expenditure obligations found in the PSC. Generally, *Minimum Work Obligations* must be fulfilled prior to making a non-consent election, proposing *Exclusive Operations* (sole risk), or withdrawing from the operating agreement. Yearly budgets and work programs must consider such *Minimum Work Obligations* so that the PSC is maintained in good standing.

III. EFFECTIVE DATE AND TERM (ARTICLE 2)

This provision is rarely contentious. The operating agreement generally becomes effective when the host government contract commences. Occasionally, the operating agreement will be modified to allow it to take effect prior to the commencement of the host government contract. This early *Effective Date* may be used when the *Parties* are incurring substantial costs evaluating an area, while waiting for the approval of the host government contract. Caution should be used when allowing the *Effective Date* of the operating agreement to precede the execution of the PSC, because, as a general rule, the *Parties* will want to delay as much work as possible until after the PSC is effective so that such expenses can be recovered under the terms of the PSC. The JOA makes it clear that the operating agreement does not terminate on the date that the host government contract terminates; rather, the operating agreement survives until final settlement has been made among the *Parties*, and those portions of the operating agreement will continue to survive until all wells have been properly abandoned, all obligations, claims, arbitrations and lawsuits have been settled or disposed of, and the time relating to the protection of confidential information and proprietary technology has expired.

IV. PARTICIPATING INTEREST (ARTICLE 3)

Generally, the *Participating Interests* of the *Parties* as set out in Article 3 will establish the percentage share ownership and billing interest of the *Parties*. These *Participating Interests* change if *Exclusive Operations* are undertaken or the government or the NOC assumes an ownership interest in the *Contract Area* under the terms of the PSC. Under these circumstances, the *Participating Interests* of the *Parties* decrease proportionately to accommodate the government participation. The contractor usually pays all of the exploration costs and, in some instances, all of the development costs, after which the government assumes its share of billing costs as well as its share of contractor equity. The *Parties* who paid the costs retain the right to recover the costs under the PSC allowance for *Cost Oil* recovery. In rare PSCs, the government or the NOC will be liable for its share of exploration and development costs; however, it remains to be determined how a contractor would go about placing a government or a NOC in default of its operating agreement obligations and hope to continue to do business in that country.

In some areas of the world, it is becoming more common for the oil companies (contractors) to carry a NOC. At some future date, were the operation successful, the NOC would become a working interest owner and would have to enter into an operating agreement. The JOA offers drafters two alternatives. First, the oil companies (contractors) may agree that they will enter into an operating agreement with the NOC if it becomes a working interest owner, but they will not necessarily make the NOC a *Party* to their operating agreement. Two operating agreements will thus be effective: one between the oil companies (contractors) and one between the oil companies (contractors) and the NOC. This situation should be avoided if possible. For an operation to be successful, good government relations must be maintained. The host government and its oil company should be treated equally, at least at the point that the NOC begins paying its proportionate share of the expenses. To accommodate this viewpoint, the JOA provides a second alternative whereby the *Parties* all agree that if the NOC becomes a working interest owner, it will become a *Party* to the operating agreement.

V. OPERATOR (ARTICLE 4)

A. OPERATOR AS INDEPENDENT CONTRACTOR

Future drafters should consider the benefits of explicitly designating the *Operator* as an independent contractor under Article 4. The drafting committee included this concept in Article 4 to insulate *Nonoperators* from certain actions of the *Operator*. It is questionable, however, whether this concept or effort at insulation will prove effective. Under Texas law, the independent contractor status will likely be ignored if *Nonoperators* exercise any significant control over the daily activities of the *Operator*. The designation provision of Article 4 should be revised to read, "is designated

Operator and agrees to act as such in accordance with the terms and conditions of this Agreement." In addition, Article 4 provides that the *Operator* has full control over its employees and labour disputes, but must employ only those people reasonably necessary for the conduct of *Joint Operations.*

B. TECHNICAL DATA

In recent years, *Operators* have become increasingly reluctant to furnish information to *Nonoperators* as part of the *Joint Account* costs. One position is that the *Operator* has its *Joint Account* copy of the information and will make it reasonably available to the other *Parties* for review and copying at their own expense. *Nonoperators* rightly take the position that they paid their proportionate part of the costs of the data and should be supplied a copy as part of *Joint Account* costs, especially since the *Operator* retains a copy for its own files. *Operators* complain that the recent proliferation of requirements to deliver data to *Nonoperators* is because of operating agreements that included NOCs as *Parties,* and that concessions made to these companies should not necessarily be made to private companies. Implicit in the debate is the desire of *Operators* to keep their traditional technical data advantage over the *Nonoperators* in a particular country. There is no easy answer to this issue; however, Article 4 attempts to require the *Operator* to deliver certain minimum information and other reports "as instructed by the *Operating Committee."* This idea works well as long as *Operator* does not have veto power in the voting procedure described in Article 5.9.

C. CLAIMS BY OR AGAINST A PARTY

The *Operator* under Article 4 is required to notify *Nonoperators* of all "material" claims or suits. Minor nuisance claims need not be immediately brought to the attention of *Nonoperators.* A *Nonoperator* would want to be notified of all claims and it is suggested that "material" be deleted. The *Operator is* given financial authority to settle "any such claim or suit or any related series of claims or suits." While it is customary for the *Parties* to specify the *Operator*'s financial authority, this provision differs slightly from the typical language of operating agreements in that, here, authority is limited to the settlement of "any related series of claims or suits." Consequently, an *Operator* with a $50,000 authorization cannot settle sixty claims averaging $1,000 each relating to an oil spill without obtaining the necessary vote of the *Nonoperators.*

Article 4 also requires a *Nonoperator* to notify the *Parties* of any claim made against it. This is relevant where a claim or suit is made against only one of the *Nonoperators.* The *Operating Committee* shall assume control over the case, and the expenses shall be paid by the *Joint Account.* A *Party* can participate in any suit, at its own expense, so long as it does not prejudice the interest of the *Operating Committee.*

D. EXTENT OF OPERATOR'S LIABILITY

The JOA, under Article 4, offers four alternatives with regard to the extent of *Operator's* liability for the *Gross Negligence* of a responsible *Party.* Under the first alternative, the *Operator* is responsible for all costs and liabilities. Under the second alternative, the *Operator* is responsible for only the actual cost and liability to "repair or replace and/or remove" jointly-owned property (*Joint Property*) so damaged or lost. Under the third alternative, the *Operator* is liable for an amount to be agreed on, and thereafter the *Joint Account* will assume responsibility for such costs and liabilities. Finally, under the fourth alternative, the *Operator* would not be responsible individually for any costs and liabilities. This fourth alternative probably will never be used and should be deleted from the JOA. Many *Operators* insisted on the inclusion of this provision, arguing that no *Party* would wish to operate unless it believed it could control its exposure. However, this view is not a reasonable alternative to which the *Nonoperators* should agree.

In the second and third alternatives, an *Operator* who breaches the *Gross Negligence* standard is required to pay a specified amount, either the replacement of the *Joint Property* or a dollar figure. Damages that exceed these levels are to be shared by the *Parties,* with each *Party* paying in proportion to its *Participating Interest,* as provided in Article 4.6. Similarly, under the fourth alternative, all expenses are shared by the *Parties* in accordance with their *Participating Interest.* To clarify this result, future drafters should consider deleting the word "only" from the second and third alternatives and adding the following: "plus its *Participating Interest* share of such additional costs, expenses and liabilities." As previously suggested, the fourth alternative should be deleted.

The *Operator's* liability under the first three of these alternatives is further limited in that the *Operator* is not individually liable for any cost and liability for environmental, consequential, or punitive damages. Under Texas law (the expressed negligence rule - *Page Petroleum* v. *Dresser Industries*) these provisions and others which attempt to relieve *Parties* of liability must be in "conspicuous type, either boldface or capital letters written."

E. REMOVAL

The JOA, under Article 4.10, addresses the highly contentious issue of removal of the *Operator* by once again offering several alternatives. As is usual, the *Operator* is removed if a court orders its liquidation, if the liquidation is voluntary, if the *Operator* becomes insolvent or bankrupt, or if a receiver is appointed for a substantial part of its assets. The *Operator* may also be removed if a specified percentage of *Nonoperators* vote to notify the *Operator* that it has committed a material breach of the operating agreement, and another specified percentage of *Nonoperators* decide that, after thirty *Days* have elapsed, the *Operator* has failed to commence rectifying the material breach. The JOA recognizes that the *Operator* may dispute that it is in material breach of the operating agreement. In this event, a successor *Operator* will not be appointed until any arbitration or litigation that may be commenced has been concluded or abandoned.

Many times *Operators* are chosen simply because they have a substantial financial responsibility for the project. For this reason, an optional provision that grants a *Nonoperator* the right to replace the *Operator* if the *Operator's Participating Interest* falls below a specified percentage has been incorporated and should be activated by the *Parties*. The usual interest chosen is the next lowest *Participating Interest*.

Article 4 also provides an optional provision that where there is a direct or indirect change of control of the *Operator* (other than the transfer of control to an *Affiliate*), *Nonoperators* have the right to replace the *Operator*. The preparers are given the ability to define the word "control." Such a provision remains necessary even if the *Parties* have chosen to include pre-emptive rights in the JOA.

The most controversial removal provision, of course, is the one providing for removal without cause. Pursuant to this provision, the *Operator* can be removed at any time if a specified number and percentage of *Nonoperators* vote to do so. No reason or cause must be alleged by those seeking to remove the *Operator*. *Operators* that are experiencing financial difficulties can be removed before they file for or are forced into bankruptcy. *Nonoperators* will not have to fight with the *Operator* over whether it has committed a material breach. Costs will be controlled because the *Operator is* aware that it can be replaced. *Nonoperators* will not, however, lightly replace the *Operator*. Because the *Operator* was chosen to operate the block, it would no doubt be expensive and otherwise detrimental to the program to replace the *Operator* in mid-stream. The threat of removal should serve to keep the *Operator* from abusing its position. If the *Operator* is doing a good job, *Nonoperators* will not seek its removal.

F. COMMINGLING ISSUES

With bankruptcy filings expanding throughout the oil and gas industry, *Nonoperators* have been requiring *Operators* to segregate the funds advanced by *Nonoperators* to cover *Joint Account* costs, rather than allowing the *Operator* to commingle such funds. In response to this concern, the JOA affords both optional and alternative language, under Article 4.8, to allow the *Parties* to fully negotiate this commingling issue. Two of the optional provisions allow the *Operating Committee* to direct the *Operator* to segregate funds. *Nonoperators* must be careful not to allow the *Operator* a veto power in the *Operating Committee* if these optional provisions are to be effective.

VI. OPERATING COMMITTEE (ARTICLE 5)

Under Article 5, the *Operating Committee* is the governing body. Each *Party* generally appoints one representative and one alternative representative. The JOA permits the *Party* representative, the alternative representative, and technical advisors to attend *Operating Committee* meetings. Some operating agreements limit the number of technical advisors who may attend *Operating Committee* meetings, because it is feared that too many people attending the meeting create obstacles to its efficient progress. The authors do not believe this poses a real problem, but if it becomes one, the *Operating Committee* can issue further rules. Issues that involve highly technical analyses can be given to subcommittees who can report to the *Operating Committee*.

A. MEETINGS

Pursuant to the JOA, *Operating Committee* meetings can either be called by the *Operator* or by a *Nonoperator* on giving at least fifteen *Days* advance notice. Such notice shall include the date, location and agenda. The agenda can be modified up to seven *Days* prior to the meeting. Only proposals included on the agenda can be voted on, unless the *Parties* unanimously agree to consider a proposal not contained in the agenda.

The *Operator* acts as chairman of the meeting and generally prepares a record of the matters voted on. Most operating agreements require the *Operator* to disseminate the minutes, and *Nonoperators* then have the right to submit objections. Frequently, the process is not detailed in the operating agreement. As a result, minutes are not promptly disseminated, *Nonoperators* respond at different times, and there is no process to address conflicts as to what the *Parties* recollect occurred during a meeting that took place five months before. To avoid this kind of problem, the JOA mandates that a record of the vote on each proposal shall be made, and the record shall be signed by each representative. Moreover, minutes of the meeting shall be provided within fifteen *Days* after the meeting, and *Nonoperators* have another fifteen *Days* to voice their objections. The JOA makes it clear that in the event of a conflict between the contemporaneous executed record and the minutes, the record will prevail.

B. VOTING PROCEDURE

Frequently, the *Parties* will want to vote by notice (telecopy or telex). Article 5 provides for a voting period specified in a number of hours if the rig is standing by and for a voting period specified in a number of *Days* in all other situations. An optional provision allows the *Parties* to approve authorizations for expenditures (*AFEs*) by notice, if *AFE* approval is required.[2]

The voting passmark or voting procedure is one of the most hotly contested provisions in any operating agreement. The JOA passmark provision provides that, unless otherwise provided, all decisions of the *Operating Committee* shall be decided by the vote of a specified number and percentage of the *Parties*. Specifying the numbers and percentage often occupies a significant part of the *Parties'* negotiations.

It is generally agreed that all the Parties must participate in fulfilling the *Minimum Work Obligations*, although the timing of such *Completion* is open for negotiation. Consequently, a *Minimum Work Obligation* cannot be performed by fewer than all the *Parties*. Beyond *Minimum Work Obligations*, proposals that are rejected are usually permitted to go forward under the sole risk provision or another provision that permits operations by less than all the *Parties*. Projects and proposals which do not attract the passmark vote will not be performed as *Joint Operations*, but are usually performable as *Exclusive Operations*. Pursuant to the *Exclusive Operations*, or sole risk, provision,

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[2] See Part VII.D, below. The parties may tailor the JOA so the AFEs are for informational purposes only.

one or more of the *Parties* can proceed with a project that fails to capture the requisite passmark vote. These *Parties,* known as sole risk *Parties,* proceed at their own risk and expense and have the sole right to production; that is, they do not have to share the production with those *Parties* that have elected not to participate in a project. The major problem with most operating agreements is that the sole risk provisions simply do not work. Since exclusive operations rarely are undertaken, many companies do not take the time and effort to properly negotiate them. They believe that all *Parties* should participate in all operations.

There are two philosophies underlying the voting passmark. First, the JOA should encourage activity, and it should neither directly nor indirectly prohibit a *Party* from pursuing activities that cannot obtain the requisite passmark vote; hence, the adoption of an effective mechanism to allow one or more *Parties* to pursue activities that are not undertaken by the *Joint Account.* Simply stated, the JOA incorporates a sole risk provision — known as *Exclusive Operations* — that works. Second, the JOA does not prohibit the pursuit of certain activities and it does not force any *Party* to participate in an operation. This election not to participate in an operation is commonly known as the right to "go nonconsent." For the sake of simplicity, all operations conducted by fewer than all the *Parties* are characterized as *Exclusive Operations.* Thus, the term *Exclusive Operations* encompasses both sole risk and nonconsent operations. All other operations are conducted by all the *Parties* and are considered *Joint Account* operations.

If a vote is taken and the proposal fails to capture the requisite passmark vote, any *Party* can conduct such operation for its own account by notifying the other *Parties* in accordance with Article 5. To conduct an *Exclusive Operation,* notification must be made within: (1) twenty-four hours if the rig is standing by; or (2) ten *Days* if the proposal involves the development project; or (3) five *Days* for all other operations. Conversely, if a *Party* voted against a proposal that obtained the requisite passmark vote, such *Party* under the JOA's nonconsent concept has the right to elect not to participate (go nonconsent), if it advises the other *Parties* of its desire within five *Days,* or twenty-four hours if the rig is standing by, of the vote.

Operations that have been commenced under the JOA can be discontinued if impenetrable substances or other conditions in the well are encountered, which, in the reasonable judgment of the *Operator,* render operations impractical. In addition, operations can be discontinued even though drilling is not impossible where the *Operating Committee* approves discontinuing operations. This might occur where the costs have substantially exceeded expectations or where the geology does not look promising. Moreover, any *Party* who wants to take over operations can do so, pursuant to the *Exclusive Operations* provision.

VII. WORK PROGRAMS AND BUDGETS (ARTICLE 6)

The Operator proposes the *Work Program and Budget,* which is subject to approval by the *Operating Committee* in accordance with a pre-agreed timetable. Likewise, appraisal and development projects must be submitted and approved. The JOA requires that *Minimum Work Obligations* must be included in the proposed *Work Program and*

Budget. As previously discussed, a *Party* may elect not to participate in an operation that is part of an approved *Work Program and Budget.*

A. CASING POINT ELECTION

The JOA includes an optional casing point election, under Article 6. Casing point elections are rarely included in international operating agreements. Some companies believe the host government will require testing of any or all discoveries. The author suggests that the casing point election will never be chosen and it should be deleted from the JOA.

B. RELATIONSHIP TO MINIMUM WORK OBLIGATION

Article 6.1(D) addresses the relationship between the *Work Program and Budget* and the *Minimum Work Obligations. Minimum Work Obligations* are to be included in the *Work Program and Budget.* If the *Parties* are unable to agree, the *Operator* is obligated to take such actions as are necessary to maintain the *Contract* in full force and effect. It is suggested that this be modified to a lower passmark vote, if the *Minimum Work Obligations* are not agreed to by the *Operating Committee.* This concept seems to be more fair than simply allowing the *Operator* to decide.

C. CONTRACT AWARDS

Another highly controversial issue was the way in which the *Operator* awards contracts for work in support of *Joint Operations.* Historically, *Operators* have been given wide discretion in awarding contracts for drilling, seismic, and their supporting operations. Since the mid-1970s, *Nonoperators* have required greater control over the *Operator's* awarding of contracts, particularly commencing in the late 1970s with the advent of investments in the oil industry by NOCs. Also, in the 1970s, the expenses associated with exploration soared as oil prices increased and forecasters predicted further increases into the 1990s. Many *Operators* entered into long-term contracts for drilling rigs and their support services at greatly inflated prices. As oil prices fell in the 1980s, so did these expenses. *Operators* who had entered into expensive long-term contracts then sought to impose them on unwilling *Nonoperators* who demanded to pay only competitive price rates prevailing at the time the services were rendered. Such operating agreements contained strictly-worded clauses preventing *Operators* from charging contract rates in excess of prevailing rates.

As a carry over from that era, Article 6.5 offers an elaborate graduated scheme of three contract-awarding procedures, ranging from little control and few approval requirements (except for awarding contracts to *Affiliates*) to involving *Nonoperators* in the analysis of competitive bids, with ultimate approval resting with the *Operating Committee.* Additionally, each of the three procedures can be activated to apply to operations falling within negotiated dollar amounts in varying degrees for exploration and appraisal operations, development operations, and production operations. For example, a contract for an exploration operation expected to cost between zero and $100,000 could be subject to the lenient approval requirements of Procedure A, while another contract for an exploration operation expected to cost between $100,000 and $500,000 could be subject to the more stringent Procedure B, and a third exploration operation costing more than $500,000 could be made subject to the most restrictive Procedure C. Figure 2 below illustrates this graduated scale for the awarding of contracts and the varying degrees of control found in Procedures A, B, and C in greater detail.

FIGURE 2

	Procedure A	Procedure B	Procedure C
Exploration and Appraisal Operations	$0 to $____	$____ to $____	>$____
Development Operations	$0 to $____	$____ to $____	>$____
Production Operations	$0 to $____	$____ to $____	>$____

1. Procedure A:

The *Operator* is to award the contract to the best qualified contractor, as determined by cost and ability. There is no requirement to obtain *Operating Committee* approval, unless the *Operator* wants to award the contract to an *Affiliate* and the contract exceeds a specific amount.

2. Procedure B:

The *Operator* is to provide *Nonoperators* with a bidder list. *Nonoperators* may reasonably request additional prospective bidders be added to the list. The *Operator* merely informs the *Parties* of the winning bidder (except that *Operating Committee* approval is necessary where the contract is in excess of a specified amount and the *Operator* wants to award the contract to an *Affiliate*) and circulates a competitive bidding analysis, stating the reasons for the choice. Upon request, the *Operator is* to furnish *Nonoperators* with a copy of the final contract.

3. Procedure C:

Procedure C is the same Procedure B, except that the *Operator* circulates the bidding analysis with its recommendation for awarding the contract and its reasons, together with the technical and commercial terms to be agreed. The *Operator* must obtain the approval of the *Operating Committee* prior to accepting the winning bid. No distinction is made for contracts awarded to *Affiliates* of the *Operator,* because all contracts require *Nonoperator* approval.

D. AFEs

AFEs can be used as a mechanism either to approve expenditures or for informational purposes only. The JOA recognizes this distinction and offers two alternatives under Article 6.6. Under the first alternative, if the work and the funds have been approved pursuant to a *Work Program and Budget, AFEs* are disseminated for informational purposes only. Under the second alternative, *AFEs* must be approved by the *Operating Committee* prior to expending any money or incurring any commitments. Voting to approve *AFEs* will ordinarily be done by notice (telecommunications). Even where *AFEs* are used as part of the approval process, there is some thought that *AFE* approvals should not be required for *Minimum Work Obligations.* If this concept is adopted, the drafter should incorporate a provision similar to the language relating to deadlocks for the *Work Program and Budget* in Article 6.1(D).

The *AFE* procedure is used by some companies to retract portions of a previously approved *Work Program and Budget. Operators* argue that *AFE*s should be used for merely informational purposes after the budget. Is it equitable and efficient to enable a second vote? Those who prefer *AFEs* argue that they serve two purposes. First, they help companies coordinate and plan for expenditures. An individual company may have approved the *Work Program and Budget,* but when it did so it may have thought that a particular expenditure would occur in the fourth quarter. If an *AFE* indicates that the expenditure will be made in the second quarter, it might be difficult for a *Nonoperator* to meet the ensuing cash call, but at least it had some notice. The second justification of an *AFE* procedure is that it provides a control on the *Operator.* This control is questionable in light of the fact that the *Operating Committee* has already approved the *Work Program and Budget* and the *Operator* has had to comply with the competitive bidding procedure before a contract is awarded.

Nonoperators on occasion manipulate the *AFE* approval process to postpone the necessity of making cash calls. And if the *Nonoperator's* financial plight is particularly problematic, it might disapprove an otherwise acceptable *AFE* in an effort to avoid or delay making an expenditure. To discourage this sort of behaviour, Article 6.6 includes an optional provision that where the approval of an *AFE is* required, a *Party* may not disapprove an *AFE* issued in furtherance of an approved *Work Program and Budget,* unless its disapproval is "duly justified" and the *Party* states the reasons for its disapproval. Although this provision by no means resolves all the problems with this issue, it may cause *Parties* to think twice before they manipulate the *AFE* approval process to benefit their cash management objectives.

The JOA, like other operating agreements, gives the *Operator* limited flexibility to exceed its *Work Program and Budget* without furnishing *Nonoperators* with a supplemental *AFE.* Consistent with the customary practice, under Article 6.7, *Operators* need not issue supplemental *AFEs,* unless the expenditures for an item on a *Work Program and Budget* exceed 10 percent of the amount authorized or the cumulative amount of all expenditures will exceed 5 percent of the total *Work Program and Budget.* The *Operator* must provide such supplemental *AFEs* when the expenditures have exceeded the authorized amounts or when the *Operator* is certain that the expenditures will exceed such authorized amounts. If the approved budget is exceeded and the *Parties* refuse to approve a supplemental *AFE* (with regard to matters other than *Minimum Work Obligations),* the operations must wind down. Perhaps the only real remedy is to replace the named *Operator* with a more cost-conscious and effective *Operator.* It is hoped that the *Parties* would have had sufficient insight to select Optional Provision 4.10(E)—removal without cause.

VIII. OPERATIONS BY LESS THAN ALL PARTIES (ARTICLE 7)

A. EXCLUSIVE OPERATIONS

Article 7.1 prohibits an *Exclusive Operation* that conflicts with an operation conducted by all *Parties,* known as a *Joint Operation.* There is some debate in the industry as to whether an *Exclusive Operation* can be proposed and conducted prior to the *Completion* of the *Minimum Work Obligation.* The JOA prohibits the proposal and conduct of an *Exclusive Operation* until after the *Minimum Work Obligation* has been fulfilled. Through the use of an optional provision, the JOA permits the *Parties* to conduct *Exclusive Operations* beyond the drilling of a well, where the *Minimum Work Obligation* as to that well has been completed but the total *Minimum Work Obligation* has not yet been fulfilled. The optional provision would, for example, permit an *Exclusive Operation* to *Deepen* the first well in a four-well program (a four-well *Minimum Work Obligation*) where the well had been drilled to the contractually obligated depth of 10,000 feet. Similarly, future drafters may wish to incorporate the concept of permitting development to take place prior to fulfilling the *Minimum Work Obligations.* To do so, consider inserting the term "or for development of an Exploitation Area" after the word "Obligations."

The JOA follows the current industry practice that the failure to reply constitutes an election not to participate in a proposal. In the unlikely event that all *Parties* elect to participate in an *Exclusive Operation,* the *Exclusive Operation* will be conducted as a *Joint Operation.*

B. PARTICIPATING INTEREST

There are two generally acceptable methods for determining the *Parties' Participating Interest.* The JOA offers both alternatives, under Article 7.2. Under the first alternative, each *Party* is obligated to assume its *Participating Interest* share of the expenses, with the numerator being the *Party's Participating Interest* and the denominator being the aggregate of all the participating *Parties' Participating Interests.* For example, if under the operating agreement there were five *Parties,* each of which owned a 20 percent *Participating Interest,* and three of the five *Parties* elected to proceed with an *Exclusive Operation,* then each of the three participating *Parties* would assume 20/60 or 33.3333 percent of the obligations. The problem with this formulation is that the number of participating or *Consenting Parties* is not known until the notice period elapses and the *Parties* have made their elections. Under this example, a *Party* with a 20 percent interest who is the only *Party* to respond affirmatively to an *Exclusive Operations* proposal could conceivably be obligated to spend 50 percent of the cost of the *Exclusive Operation.* Many companies are uncomfortable with the notion that they are unaware of their exact *Participating Interest* at the time they make their election.

To address this lack of certainty, some operating agreements do not require an *Exclusive Operation* (sole risk operation) to go forward unless all the participating *Parties* are content with their assumed interest. Article 7.2, in an alternative, gives each

Party which elects to participate in the *Exclusive Operation* the option to: (1) limit an interest to its *Participating Interest* under the JOA (in the above example, 20 percent); (2) accept an interest equal to its *Participating Interest* over the aggregate of the *Participating Interest* of the participating or *Consenting Parties*, the formulation employed in the alternative previously discussed (in the above example, 33.3333 percent); or (3) for those *Parties* that truly love the operation, take the percentage interest obtained in (2) (33.3333 percent) plus all or any part of a shortfall occurring because one or more of the *Parties* elected (1), limiting its interest to its *Participating Interest*. If no *Party* elects to pick up the shortfall in accordance with the third option, and any *Party* elects to limit its interest to its *Participating Interest* in accordance with the first option, 100 percent of the interest will not be subscribed. If no *Party* voluntarily elects to assume the outstanding interest within twenty-four hours after the appropriate response period, the proposal to proceed with an *Exclusive Operation* will terminate.

C. GEOPHYSICAL AND GEOLOGICAL COSTS

The JOA, under Article 7.4, further addresses the age-old question about what to do if some, but not all, of the *Parties* want to conduct certain geophysical, geological or geochemical work. Those *Parties* who desire to conduct such work can do so for their own account as an *Exclusive Operation*. Non-participating *Parties* can later acquire access to such data by paying a premium.

D. PREMIUMS

To accommodate all views, Article 7.4 offers three alternatives: (1) a *Cash Premium*; (2) an *In Kind Premium*; or (3) at the choice of the *Nonconsenting Party*, either a *Cash Premium* or an *In Kind Premium*. *Cash Premiums* must be paid in a timely way or the *Nonconsenting Party* forfeits its right to participate. *Cash Premiums* and *In Kind Premiums* are paid to those *Parties* who have expended funds in pursuing the *Exclusive Operation*. *A Nonconsenting Party* who paid the requisite premium is not entitled to any share of funds contributed by another *Nonconsenting Party* who subsequently pays a premium. This concept is not included in most operating agreements, and its failure to be addressed will likely cause substantial conflict between those *Parties* who expended the risk dollars and those who paid the premium and now argue they have full rights and are entitled to a portion of all subsequent premiums paid.

A Nonconsenting Party who does not elect to pay its *Cash Premium* under Article 7.4 so as to participate by the time a *Development Plan* is proposed has, under the JOA, forfeited its legal interest in the host government contract, if the law permits, or its economic interest in the development operation. For practical and financial reasons, a *Nonconsenting Party* is not able to buy into a development project by paying a premium based on the cost of the development facilities.

Article 7.4 makes it clear that the *Consenting Parties* own and take 100 percent of the *Nonconsenting Party(s)'* share of production, including *Cost Oil* and *Profit Oil* in the context of a production sharing contract. In the case of a service agreement, *Cost*

Oil would be characterized as a reimbursable expenditure, and *Profit Oil* would be characterized as a service fee. Under Article 7.5, only production from the *Exclusive Operation* is used to satisfy the *In Kind Premium*, and if production terminates prior to payout of the *In Kind Premium*, no debt is owed to the *Consenting Parties*.

As a general rule, "cash" premiums tend to be in the 500 percent range, while "in kind" premiums are usually larger in the 1,000 percent to 1,500 percent range.

IX. DEFAULT (ARTICLE 8)

As a consequence of the growing number of bankruptcies in the oil and gas industry and the proliferation of new international players, the default provision in many operating agreements is being used with greater frequency. A *Party* who fails to pay its share of expenses is classified as a *Defaulting Party*. A *Defaulting Party* must pay interest on the money owed, plus run the risk of losing its rights and interest under the JOA and PSC. The JOA does not incorporate the concept of anticipatory breach, which would allow a *Party* who had failed to pay its cash calls to be placed in default for its share of the entire balance owed under the *Minimum Work Obligation*.

A *Party* has five *Business Days* from the date of notice of default to make payment. If payment is not made within such period, the *Defaulting Party* is prohibited from attending *Operating Committee* meetings and voting. Moreover, the *Defaulting Party* is denied access to any data or information relating to *Joint Operations*, and the *Defaulting Party* has no voice in the trading of such data nor any rights to data obtained as a result of a trade. Within five *Days* of notification, each of the non-defaulting *Parties* is required to pay *Operator* its share of the amount not paid by the *Defaulting Parties*. If the non-defaulting *Parties* do not promptly pay their share of such shortfall, they will likewise become *Defaulting Parties*. The debt shall include all amounts owed, interest and the estimated *Defaulting Party's* share of all costs to abandon the property. A *Party* cannot circumvent its obligation to pay its share of abandonment expenses by defaulting in the later stages of a production operation. The JOA, to this extent, adopts the concept of anticipatory breach. A default accelerates the abandonment obligation.

In addition to the right to seek a monetary payment for all amounts due (including abandonment expenses) and interest, the non-defaulting *Parties* can require that the *Defaulting Party* transfer its interest to the non-defaulting *Parties*. The JOA deems a transfer to have taken place if so elected by the non-defaulting *Parties* who have been empowered to execute on behalf of the *Defaulting Parties* all documents to effectuate a transfer. Some countries may not accept this transfer procedure, and in such an event, the JOA provides that each *Party* shall execute a power of attorney in a form prescribed by the *Operating Committee*. The *Defaulting Parties* contractually agree to do whatever is required to *Complete* the transfer of their interest. Transfers are to be held in trust between the time an election to transfer is made and the time the host government approves such transfer, assuming the transfer is subject to host government approval. A *Defaulting Party* can remedy its default by paying to the *Operator* the amount due plus interest at any time prior to the transfer of its interest.

Under the JOA, the *Parties* further agree that they will not seek to set off against the debt any related or unrelated claim. Furthermore, the *Parties* agree that they will not contend that the remedy or the amount of such remedy is unreasonable or excessive.

X. DISPOSITION OF PRODUCTION (ARTICLE 9)

The JOA requires that the *Parties* take in kind and separately dispose of their production. The JOA provides the material issues that should be included in a future offtake agreement, leaving the formal agreement to be determined later when a development and exploitation plan has been approved.

XI. ABANDONMENT OF WELLS (ARTICLE 10)

The JOA follows the general rule that no well should be abandoned until all *Parties* who have participated in the well or have acquired an interest in it consent to its abandonment. Any *Party* can take over a well that has been proposed to be abandoned at its sole risk and cost. The JOA makes it clear that those *Parties* taking over a well, called *Consenting Parties,* shall be entitled to produce only from the *Zones* or formations then open to production. The *Consenting Parties* are not permitted to *Recomplete* the well at a different *Zone* at the time they take over or at some time in the future, unless they obtain permission to do so from all *Parties* owning an interest in that *Zone.* To compensate the *Parties* that wish to abandon the well, the *Consenting Parties* must pay such *Nonconsenting* or abandoning *Parties* their share of the salvable material and equipment, less the cost of salvaging and the estimated cost of plugging and abandoning as of the date of takeover.

XII. TRANSFER OF INTEREST OR RIGHTS (ARTICLE 12)

A. SMALL INTERESTS

Transfer provisions are of extreme importance as the life of a property may extend for many years and see many transfers. It often becomes burdensome for the *Operator* and the *Operating Committee* to function with more than five *Parties.* As a consequence, the JOA restricts the minimum *Participating Interest* to negotiated interest. The usual amount to be included is a 10 percent interest.

B. EFFECTING THE TRANSFER

The JOA provides that the transferring *Party* shall be liable for all obligations that have vested, matured or accrued. The transfer is not valid until approved in writing by the host government, and no transfer is valid until all *Parties* have consented to such transfer. The *Parties'* consent can only be denied if the transferee fails to establish to the reasonable satisfaction of each *Party* its financial and technical capability. *Parties* can mortgage or encumber their interest as long as they remain liable for all obligations and obtain the requisite host government approvals.

Two issues should be recognized in connection with a transfer under the JOA. First, the transfer document is not just an assignment; rather, it is a novation that must be executed by all *Parties* and the host government. Second, the transferee is required to establish both its financial and technical capability. The JOA recognizes that the technical capabilities of *Nonoperators* may be important to certain *Operators* and the *Operating Committee.*

C. PREFERENTIAL PURCHASE RIGHTS

The issues surrounding preferential purchase rights are extremely controversial and currently a hot topic for debate and conflict. The JOA offers the preparers a series of options to enable them to structure their agreement in a flexible fashion. The preparers can select an optional preferential purchase right provision that would give all *Parties* the right to match the price and acquire the interest sought to be sold. In accordance with this provision, any transfer — whether direct or indirect, (excepting transfers with or to an *Affiliate*) — is subject to the preferential purchase right. The language "whether directly or indirectly" is designed to capture sales of a parent company, whether the parent company was in existence long before the contemplated sale or whether the parent was created in contemplation of the sale. Many preferential purchase right provisions can be circumvented either by selling the parent company or, if this is not convenient, by creating a new company and superimposing it in the corporate structure as the parent of the entity sought to be sold. This provision is intended to avoid this circumvention. The prevailing opinion is that the JOA will not bind the shareholders of a party and therefore, can be circumvented. In any event, pre-emptive rights generate a great deal of discussion and should be deleted from all agreements, in order to avoid later discord and determination of the value of the assets. In fact, many prospective purchasers will refuse to review properties with pre-emptive rights. Their view is that if a fair price is agreed, the sale will be pre-empted. If the sale is not pre-empted, then the purchaser overpaid for the assets. It is a no-win situation so purchasers avoid even reviewing the property.

XIII. RELATIONSHIP OF PARTIES AND TAX (ARTICLE 14)

The rights, duties and obligations are individual as opposed to joint or collective. The *Parties* disclaim the intention to create a partnership (or other entity) to avoid the liability and tax consequences of creating these entities. The JOA provides that the *Parties* are not to be considered fiduciaries in order to avoid liabilities and obligations associated with this status.

While the *Operator* is generally charged with the responsibility to pay all bonuses, rentals, royalties, production payments and related payments, each *Party* is responsible for the payment of its own income taxes. Under the JOA, each *Party* agrees to defend and indemnify each of the others from any loss, cost or liability relating to a *Party's* failure to pay its income taxes. Thus, a government tax lien, resulting from the failure to pay income tax to the host government would have to be immediately discharged and removed.

XIV. CONFIDENTIAL INFORMATION AND PROPRIETARY TECHNOLOGY (ARTICLE 15)

The JOA requires that the *Parties* not disclose data derived from *Joint Operations* for a negotiated period of time (commonly one to two years) after the termination of the PSC and operating agreement. The usual list of exceptions to this requirement are found in the JOA:

(1) to *Affiliates*;
(2) to Governmental agencies where necessary;
(3) as required to comply with laws, regulations, rules of a stock exchange, or legal discovery proceedings;
(4) to potential contractors and consultants;
(5) to prospective purchasers of any interest for sale;
(6) to banking institutions to secure financing to cover its obligations under the PSC and the operating agreement;
(7) to employees for the purpose of furthering *Joint Operations*; and
(8) for information that becomes part of the public domain through no fault of the disclosing *Party*.

Since the larger companies wanted to protect their proprietary technology base, the JOA allows the owner of such technology to keep it from the other *Parties,* unless such technology was developed at the expense of the *Joint Account.* In such a case, all the *Parties* paid their share of expenses and own the technology developed.

Regarding well data, the *Operating Committee* may authorize the *Operator* to make any trade of well data on behalf of the *Parties* provided all *Parties* have access to the incoming data, if the outgoing data were acquired through the *Joint Account.*

XV. *FORCE MAJEURE* (ARTICLE 16)

Force majeure provisions are critically important in the PSC in order to avoid termination of rights to the contract area. The JOA provides that a *force majeure* notice must be disseminated to the other *Parties* within a reasonable time after a *Party* becomes unable to continue performing. The notice should state the reasons for *force majeure* and the estimated period necessary to remedy the situation. The *Party* invoking *force majeure* must keep the other *Parties* apprised of all significant developments and must use all "reasonable diligence to remove or overcome the *force majeure* situation as quickly as possible in an economic manner." During the pendency of the *force majeure* event, performance is suspended. Some *force majeure* provisions provide that if the *force majeure* event continues beyond a specified number of years, the PSC shall terminate.

The preparers can define *force majeure* broadly to include all circumstances that are irresistible or beyond the reasonable control of the *Party.* Alternatively, *force majeure* can be more narrowly defined to include only those circumstances set out in the PSC. As a general rule, *Operators* will prefer a broad definition of *force majeure,* while

Nonoperators prefer to allow an *Operator* to be able to claim *force majeure* only if it is available under the PSC.

XVI. APPLICABLE LAW AND DISPUTE RESOLUTION (ARTICLE 18)

While the host government will often require that its law govern the PSC, the *Parties* are generally free to specify the law governing their relations amongst themselves. The JOA provides for dispute resolution either in the courts or through arbitration. Virtually all operating agreements will use the arbitration provisions.

The JOA allows the option of appointing one or three arbitrators. The appointment of a single arbitrator will no doubt be less expensive and will likely permit the proceedings to be completed more quickly. On the other hand, *Parties* sometimes feel more secure with a three party arbitration panel, especially when substantial sums are involved. The JOA provides that the arbitration proceedings will be held in a specified place; the arbitrators will all be fluent in English and the proceedings will be conducted in English; the arbitrators will be independent and neutral; and the proceedings will be conducted in accordance with specified arbitration rules. *Parties* can specify, among others, the rules of the International Chamber of Commerce, the International Centre for Settlement of Investment Disputes, or the American Arbitration Association. By doing so, the arbitration will be conducted in accordance with an established set of rules and procedures and will have the benefit of an organization to help promote the arbitration. These institutional organizations can be expensive and at times inefficient. To avoid this additional expense and delay, *Parties* are adopting *ad hoc* arbitration procedures. The United Nations UNCITRAL rules are frequently adopted.

XVII. ALLOCATION OF COST RECOVERY RIGHTS (ARTICLE 19)

The drafters of the JOA recognized that with the incorporation of a workable *Exclusive Operations* provision (sole risk provision), a nonconsent provision, and a casing point election, accounting problems will arise in determining each *Party's* share of production. Unless the *Parties* agree in advance, it may be difficult for the *Parties* to maximize the use of *Cost Oil* (or its equivalent). The host government contract allows *Cost Oil* to be allocated anywhere within a large block (which may encompass several separate producing areas with different *Parties* and interests). Article 19 simply attempts to re-allocate shares of production in a fair and equitable manner given the circumstances.

XVIII. CONCLUSION

In summary, the JOA offers the oil and gas industry a flexible, well written document to govern international oil and gas operations. The JOA can be used in all countries and with all host government contracts with little modifications. Most of these modifications will be found in the definitions, which are designed to fashion the agreement to a particular PSC regime. Thus far, the response by the industry has been nothing less than outstanding. Negotiation time has been cut by as much as 75 percent. The authors continue to review and refine the JOA and expect to publish a 1995 version in the first half of the year.