

The Effects of Default, Transfer, and Withdrawal Provisions on JOA Exits:

Should I Stay or Should I Go?

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Abstract: Default, transfer of interest or rights, and withdrawal are *prima facie* three distinct clauses in a Joint Operating Agreement (JOA). They serve different purposes and are subject to different conditions. But at the same time, they may all lead to a party's exit from the JOA. Although these concepts have been long analysed in theory, practice, and jurisprudence, the extent to which they all fit together in the same context remains unclear. Important questions arise about their interconnection, and with regards to compensation and liability of the departing party. The answer to these questions may ultimately determine the consequences of each 'exit strategy' and which way would be the best if a member contemplates leaving the JOA. By shedding light to the above topic, this analysis seeks to inform theorists and professionals alike.

Keywords: joint operating agreement; default; transfer of interest or rights; withdrawal; compensation; liability

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1. Introduction

This paper examines the legal relation between default, transfer of interest or rights, and withdrawal. The above contractual mechanisms are inextricable parts of petroleum industry. They are embedded in every Joint Operating Agreement (JOA) regardless of its form and governing law. Default, transfer of interest or rights, and withdrawal have long concerned legal theory and practice. Much has been said about each mechanism's nature, features, and associated challenges.

However, the ways in which these subjects fit together remains unclear. Default, transfer of interest or rights, and withdrawal are *prima facie* three distinct concepts. They serve different purposes and are subject to different conditions. But at the same time, they may all lead to a party's exit from the JOA, which creates an interconnection among them. By exploring this relation, the analysis seeks to inform scholars and practitioners on some important aspects. First, the paper will provide the main features of the three mechanisms. Next, the study will compare and evaluate the above concepts, as this may ultimately determine the consequences of an "exit strategy" if a member wishes to leave the JOA. A synthesis of the reached findings will give rise to the conclusion of this study.

2. Industry Practices and Rationale

Joint Ventures (JVs) are established to last for a long time. To achieve that, certain provisions are inserted in the JOA enabling the consortium to be flexible and responsive towards operational and market challenges or changing circumstances. Although the members of the JOA form the consortium with the same vision, they may see it change during the life of the JV. A party may no longer be able to meet its financial obligations to the JV, another may wish to sell its share in the JV, whereas another may simply wish to abandon its participating interest. The respective provisions which address those situations in the JOA are: default, transfer of interest or rights, and withdrawal.

2.1.Default Provision

The term default generally describes the failure of a JV member to contribute its allocated participation in the costs of the joint operation.² Other breaches or failures (non-monetary) by a party to comply with the terms of the JOA on the broader sense (e.g. breach of confidentiality, invalid transfers of interests, etc.) might be dealt with through the general liability provisions

² Bernard Taverne, *An Introduction to the Regulation of the Petroleum Industry: Law, Contracts and Conventions* (Graham & Trotman 1994) 141.

of the JOA.

Nonetheless, a JOA might be drafted so as to include other types of default too, such as: failure of a party to procure collateral support when it is required to do so; failure to meet indemnity obligations; failure to comply with financial qualifications and solvency status; compliance issues related to international sanctions, and it might even extend under the JOA to any default that takes place under the terms of the host granting instrument.³ In addition, the default might comprise both a failure to make payment at a definite date as well as a subsequent default (accumulation of cumulative delayed payments) within a delimited period of time. However, the precise definition of default should be consistent with the applicable law as such legal definition might prevail in case of conflict to the contractual definition agreed by the JOA parties.

Yet, a default may not only happen when a party is financially unable to meet its share of a cash-call or invoice request. There can be other reasons for default, such as the attempt to seek cheap finance at the expense of fellow members, or because a party might be aware of the “weak” financial status of one or more of its co-venturers and decides to increase costs or delay the project to force such party to enter in a default, or because a party to the JOA anticipates that other parties may default and does not want to assume the consequences of the co-venturers’ default, or simply to “release” financial resources or other assets. This may be defined as “strategic default.”⁴

The above demonstrate that the meaning of default depends on the context in which it is invoked, *viz.*, on the JOA in question in every specific case. What is described as default in one contract may not be in another.

The remedy to default has also evolved throughout the decades -from the traditional sequestration (forfeiture) to the less draconian: lien, mortgage and/or security interests, withering interest, and buy-out. Under lien, mortgage, and security interest, each party to the JOA grants to each of the others in *pro rata* shares a mortgage and security interest on its participating interest (and all the properties and proceeds derived from it), to secure payments and other securities required under the contract. Thus, in case of default, non-defaulting parties will have the right to foreclose the mortgage and security interest to sell it by means of either

³ David Sweeney, *Oil and Gas Joint Operating Agreements: A Comparative World-Wide Analysis* (LexisNexis 2015) 9.03 [2]; Peter Roberts, *Joint Operating Agreements* (Globe Law and Business 2015) 210.

⁴ Eduardo Pereira et al, ‘Default Provisions’ in Eduardo Pereira and Wan Zulhafiz (eds), *Joint Operating Agreement (JOA): Applicability and Enforceability of Default Provisions* (RMMLF, due to publication in 2018) 11.

a public or private sale (even among the non-defaulting parties).⁵ The sale proceeds will be applied to cover the amount in default and related costs but any excess will be returned to the defaulting party.

With withering interest, the defaulting party will only have forfeited a proportionate part of its interest corresponding to a mathematical formula considering the default amount in relation to the total estimated expenditures and some sort of discount mechanism (which might vary in accordance with the stage of the default).⁶ Hence, it might remain in the petroleum project but with a reduced level of interest.

Finally, the buy-out is a compulsory sale of the defaulter's interest. The defaulting party will be compelled to sell all or part of its participating interest to the non-defaulting parties (or to third ones) with a purchase price to be agreed between them or determined by an independent expert in case of dispute, which should consider the net sums in default, an agreed discount and other associated costs.

The concern about the enforceability of the default mechanism was the primary reason why those other remedies were developed. Questions as to whether forfeiture of the participating interest should be unenforceable as penalty under common law⁷ or as contradictory to the rules of insolvency,⁸ or whether courts should grant compensation against forfeiture of the defaulting party's interest⁹ have led industry to introduce other default remedies. These are now inserted in the default clause of the JOA either as alternative or as complementary to forfeiture.¹⁰

Despite the flexibility in the meaning of default and the evolution behind its use in petroleum industry, the rationale behind this provision is quite straightforward: default seeks to secure the financial obligations and commitments of the consortium. This rests on the fact that a JV is a relationship based on co-operation, mutual trust, and cost-sharing between its members.

⁵ Note that the exercise of this option will nevertheless be subject to the law applicable to the contract. That is, it might be that the state has a pre-emption right to acquire participating interests under the JOA or that the transfer is subject to its approval.

⁶ Sweeney (n3) at [6]A: "the reduction in the interest forfeited is generally calculated using the amount in default, the estimated total cost of the development plan to which the default relates, and a sliding multiple based on the level of completion of the execution of the relevant development plan at the time of default".

⁷ "This is based on the principle that under the rules of equity a provision will be unenforceable if it is imposed 'in terrorem'; that is, where it is intended to enforce the performance of a contract by a defaulting party rather than to compensate the non-defaulting party for a breach of contract." Roberts, *Joint Operating Agreements* (n3) 225; *Wyllie v Wikes* (1780) 2 Dougl 519; Michael Taylor and Sally Tyne, Taylor and Winsor on *Joint Operating Agreements* (2nd edn Longman 1992) 95.

⁸ *British Eagle International Airlines Ltd v CieNationale AirFrance* [1975] 1 WLR 758 (UK); Eduardo Pereira and David Sweeney, 'Insolvency' in Eduardo Pereira and Wan Zulhafiz (eds), *Joint Operating Agreement (JOA): Applicability and Enforceability of Default Provisions* (RMMLF, due to publication in 2018) 85.

⁹ See below discussion about compensation.

¹⁰ See AIPN §8.4; CAPL §5.05A; AMPLA §15.6; OGUK §17.6.

Petroleum exploration requires vast capital expenditures, hence every JOA creates serious financial commitments to its members. The mechanism of default seeks to address the failure of a co-venturer to meet its financial obligations towards the consortium.

It can be argued that the nature of a default provision is both preventative (or psychological) and responsive (or practical). It is preventative as it primarily threatens the potential defaulter with forcible ejection from the JV and loss of its participating interest therein, and responsive, for it triggers certain remedies once default is actually effected. Either way, the purpose of default provision is to provide certainty and stability for the financial contributions which will be required throughout the life of the consortium.

If a party is in default beyond a defined period of time and without credible and legal reasons, then such party is likely to be removed from the consortium. The potential removal of the defaulting party from the JOA is more likely to be forced by the non-defaulting parties than be voluntary. Although such removal might be effective, in that it would allow the JV to remain alive and even prevent other members from failing to meet their financial obligations, it is not without legal problems. The forcible sequestration of the defaulter's participating interest might be considered too excessive or even unfair, depending on the circumstances of default and the defaulter's stance towards previous cash calls.¹¹ Hence, several JOAs offer more "moderate" options to remove or dilute the share of the defaulting party (e.g buy-out, withering interest). Also, forfeiture may be followed by compensatory relief in order to increase its chances of enforceability under the applicable law.¹² Hence, even when forfeiture is deemed to be enforceable but is also unconscionable, *viz*, exorbitant in relation to the value of default, it may be reduced by the competent court or tribunal (e.g under the doctrines of proportionality

¹¹ The enforceability of forfeiture falls outside the scope of the present paper, as it is covered in other works of the lead author.

¹² "By following the analogy of the protecting leasehold interests, where a tenant can apply to the court for relief from a landlord's action for forfeiture of a lease because of the tenant's fault." Roberts, *Joint Operating Agreements* (n3) 227-228.

or unjust enrichment).¹³

Despite its potential ejection from the consortium, the defaulting party remains liable for its share of costs prior to its removal which should be covered through its participating interest.¹⁴ It must also cover any legal or other enforcement costs of the non-defaulting parties associated with default.¹⁵ Still, a complex issue arises about the defaulter's decommissioning obligations. Typically, the defaulting party remains liable and will cover its decommissioning obligations through allocation of its participating interest to the non-defaulting parties. If default occurs in the early stages of production, the production revenues might be able to cover decommissioning costs.^{16 17}

However, problems may arise during the final stages of development, as the petroleum title may no longer be an asset but a burden.¹⁸ According to Shaw "it should not be open to a party to withdraw from the JOA by way of defaulting on its obligations and escape abandonment liability. Modern JOA's usually provide for this ongoing liability, much the same as in the withdrawal provisions."¹⁹ The parties should be cautious of that and take extra care when drafting the default obligations.²⁰

¹³ For the proportionality of a penalty in civil law see: Article 1152 of the French Civil Code; Section 343 of the German Civil Code; Article 163 of the Swiss Code of Obligations; Article 6.73-3 of the Lithuanian Civil Code; Arts 412-413 of the Brazilian Civil Code. For the consideration of forfeiture in common law see: *Cavendish Square Holdings BV v Talal El Makdessi* [2015] UKSC 67 and *ParkingEye Ltd v Beavies* [2015] UKSC 67; *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd* [1915] AC 79; *Commissioner of Public Works v Hills* [1906] AC 368; *Mosaic Oil NL v Angaari Pty Ltd* (1990) 8 ACLC 780 (New South Wales Supreme Court); *Elsley v JG Collins Ins. Agencies* [1978] 2 S.C.R. 91; *Ontario Ltd. v Torrey Springs II Associates Limited Partnership* [2004] Carswell Ont. 4306. See also, Simas Vitkus, 'Penalty Clauses within Different Legal Systems' (2013) 1 *Social Transformations in Contemporary Society* 153; 157; Aristides Hatzis, 'Having the Cake and Eating it Too: Efficient Penalty Clauses in Common and Civil Law Contracts' (2003) 22 *International Review of Law and Economics* 386; Jack Greaves, 'Penalty Clauses as Remedies: Exploring Comparative Approaches to Enforceability' (2013) *Touro Law Review* 32(1) 684-686; Aaron Cooper and Flavio Inocencio, 'Forfeiture, Buy-Out Provisions and Enforceability Under English Law After the Makdessi Decision', Eduardo Pereira and Wan Zulhafiz (eds), *Joint Operating Agreement (JOA): Applicability and Enforceability of Default Provisions* (RMMLF, due to publication in 2018) 126.

¹⁴ AIPN §8.4; 8.6; OGUK §17.

¹⁵ AIPN §8.4J; OGUK §17.8. These are likely to be added to the total amount of default. Roberts, *Joint Operating Agreements* (n3) 217.

¹⁶ Taverne, *An Introduction to the Regulation of the Petroleum Industry* (n2) 141.

¹⁷ "(a)s long as a defaulting party remains in default it is no longer entitled to receive its share of the petroleum production: this share will be taken by the operator and distributed among the non-defaulting parties." Taverne, *An Introduction to the Regulation of the Petroleum Industry* (n2) 141.

¹⁸ Eduardo Pereira, 'Protection Against Default in Long Term Petroleum Joint Ventures' (2012) *Oxford Institute of Energy Studies WPM* 47, 1; 14.

¹⁹ Sandy Shaw, 'Joint Operating Agreements' in Martyn David (ed), *Upstream Oil and Gas Agreements* (Sweet and Maxwell 1996) 25.

²⁰ 'It is essential that detailed provisions governing security for the costs of decommissioning are negotiated far enough ahead of the point at which a field becomes uneconomic for any party, so that the party does not pre-empt its abandonment obligations crystallising by withdrawing early from the venture.' Charez Golvala, 'Upstream

2.2. Transfer of Interest or Rights Provision

Typically, a JV is set up for a long period of time. The completion of exploration and the production of petroleum from the relevant field(s) for which the consortium has been established may take several decades. Within this time, it is typical that changes be effected in the structure and the members of the consortium. Such change is the transfer (wholly or partly) of a member's interest or rights in the JV to another party (whether from the consortium or a third one) in exchange for a monetary consideration.²¹ Hence, although the JOA was originally signed between certain members, it may end up with additional or different participants.

There are many reasons why a member of the JOA decides to transfer its share in the JV. A profound reason is the realization of the value of that party's assets.²² Every participating interest in the consortium has a monetary value, giving its holder the right to sell, assign, or liquidate it. The acquired amount of money will allow the transferor to cover its finance debts and/or capitalize that money.²³ But it is also possible that many transfers are attributed to the companies' strategy to divest their assets as they are too costly to maintain or in order to invest to more profitable areas (e.g. abandon a mature province for a newly-discovered one) or other corporate and/or internal/external reason.²⁴

Notwithstanding, a transfer of interests should not be without rules or limitations, nor contradict the interests of the existing/remaining members of the consortium.²⁵ Accordingly, it is common for a JOA to bear clauses which will regulate issues concerning such change in the JV (i.e. conditions of transfer) like: governmental approval, the exercise of pre-emption rights, the right of first refusal etc, consent by remaining parties and/or approval of the identity of the transferee.²⁶ In the rare situation where the contract is silent on the transfer of interest or rights,

joint ventures –bidding and operating agreements` in Geoffrey Picton Turbervill (ed.), *Oil and Gas: A Practical Handbook* (Global Law and Business 2009) 50; Pereira, 'Protection Against Default' (n18) 14.

²¹ Roberts, *Joint Operating Agreements* (n3)147. A transfer can be effected either with the purchase of the asset itself or by a share purchase of the company which owns the particular interest.

²² Eduardo Pereira, Aina Gomez Picanyol, and Waniss Otman, 'Default and its Remedies in the Context of the JOA' in Eduardo Pereira and Wan Zulhafiz (eds), *Joint Operating Agreement (JOA): Applicability and Enforceability of Default Provisions* (RMMLF, due to publication in 2018) 5-34.

²³ Norman Wisely, 'Acquisitions and Disposals of Upstream Oil and Gas Interests', in John Paterson, Greg Gordon, and Emre Usenmez (eds), *Oil and Gas Law: Current Practice and Emerging Trends* (2nd Edn, Dundee University Press 2011) 523-524.

²⁴ *ibid.*

²⁵ It is possible that the other members of the JV object to this transfer and the dispute ends up to arbitration. See Aina Gómez Picanyol, 'Transfers of Interest in Joint Operating Agreements', in Eduardo Pereira and Keith Holl (eds), *Joint Operating Agreement: Operatorship Role, Options and Concerns* (2017) 486 Mariou -Scandinavian Institute of Maritime Law 97-152.

²⁶ The JOA will usually provide that a party cannot transfer its interest (or rights/obligations) under the contract without the consent of the non-transferring contracting party. Peter Roberts, *Petroleum Contracts* (Oxford University Press 2013) 359. Also, the JOA usually provides that the operator cannot assign the operatorship

a party to the JOA will still be free to do so subject to the rules of the applicable law.²⁷ An analysis of those requirements falls outside the scope of the present study. However, it is worth to mention that any attempted transfer in breach of those contractual or statutory provisions would be invalid for the non-transferring parties.²⁸ Such transfer would be effective between the transferor and the transferee but could give rise to a claim for a breach of warranty and representation within the transfer agreement.²⁹

A transfer of a joint venturer's interest or rights in the consortium may take various types. But the main options would be either an asset transaction (i.e. assigning of participating interest in the relevant host granting instrument) or corporate transaction. (i.e. assigning of shares in the relevant target company).³⁰

In the case of transfer of interest or rights, the allocation of liability will need to be arranged between the concerned parties. The event of assignment to a third party will not necessarily release the assignor from its obligations under the JOA up to the assignment date. That is to say, if the assignee fails to meet its obligations towards the consortium, the non-assigning parties of the JOA may be able to pursue the assignor to enforce those obligations.³¹ It is important that the JOA specify whether the assignor will remain liable upon the transfer or not, and to what extent.³² It can be agreed that the transferor will remain liable up to the transfer date and that the transferee will assume liability thereafter,³³ or that the transferee will be fully liable for all costs.³⁴ Alternatively, the parties may agree that both the transferor and the transferee will be liable for the transferor's share of obligations which have accrued prior to the transfer (e.g., pre-approved decommissioning costs).³⁵

without the consent of the participants or the regulatory authority. That is the case in Great Britain, where the consent of the Secretary of State for Energy to a proposed assignee of the operator is required (OGUK Model Form §23.4). Kenneth Mildwaters, *Joint Operating Agreements. A Consideration of Legal Aspects Relevant to Joint Operating Agreements Used in Great Britain and Australia by Participants thereto to Regulate the Joint Undertaking of Exploration for Petroleum in Off shore Areas with Particular Reference to their Rights and Duties*, PhD Thesis, University of Dundee (1990) 491. The same applies in AIPN JOA § 4.12; §12.2D.

²⁷ Roberts, *Petroleum Contracts* (n26) 358.

²⁸ *Lindens Gardens Trust Ltd v Lenesta Sludge Disposals Ltd* [1994] 1 AC 85; *British Energy Power & Energy Trading Ltd v Credit Suisse* [2008] EWCA Civ 53. For transfer without prior ministerial authorization see, *Occidental Petroleum Corporation, Occidental Exploration and Production Company v The Republic of Ecuador Award*, ICSID Case No. ARB/06/11, 5 Oct 2012, 54.

²⁹ Roberts, *Petroleum Contracts* (n26) 359.

³⁰ Wisely (n23) 524-525.

³¹ Pereira, 'Default Provisions' (n3) 17.

³² *ibid.*

³³ Roberts, *Petroleum Contracts* (n26) 361.

³⁴ OGUK §23.3.

³⁵ See AIPN JOA Model Form §12. King & Spalding, 'Practical Issues Under Joint Operating Agreements Relating to Withdrawals, Transfers and Changes in Control', available at <<https://www.kslaw.com/blog->

2.3. Withdrawal Provision

The final provision to be examined is withdrawal. Under this mechanism, a party issues an unconditional and irrevocable notice to withdraw from the JOA, resulting to the assignment of its participating interest to some or all of the remaining parties, free of cost.³⁶ If the remaining parties refuse to receive the withdrawing party's participating interest or if all members decide to withdraw from the agreement, then the JV will be terminated.³⁷

Withdrawal is typically employed when a party has no longer the same incentive or interests to remain in the consortium but does not have the time or cannot find another party to transfer its interest to under the desired terms, or simply because the project does not have commercial value.³⁸ This may be the case when the exploration and appraisal programme have been proved disappointing and the party wants to avoid commitment to further expenditure, when a given State sanctions are suddenly imposed and may affect the party's investment, or when the party seeks to prevent a potential default.³⁹

To escape a 'lock in', such party may exit the consortium and its participating interest will be allocated to the other members in proportion to their own participating interests.⁴⁰ As Roberts observes, withdrawal is 'the equivalent of the right of a party to a commercial contract to terminate its participation in that contract at any time for convenience and to allow the remaining parties to pick up the terminating party's interests.'⁴¹

In essence, withdrawal allows a member of the JOA to 'surrender' its participating interest in the JV and 'abandon' its rights and obligations.⁴² It can be argued that a party's desire to withdraw from the JOA may trigger 'a rush for the door', as the other members may also elect to withdraw instead of acquiring the departing member's participating interest.⁴³ So, any withdrawal may eventually lead to termination of the JOA to the extent everyone decides to

[posts/practical-issues-under-joint-operating-agreements-relating-to-withdrawals-transfers-and-changes-in-control/](#)> accessed 29 May 2018.

³⁶ King & Spalding (ibid).

³⁷ Bernard Taverne, *Petroleum, Industry and Governments: An Introduction to Petroleum Regulation, Economics and Government Policies* (International Energy & Resources Law & Policy 2000) 380.

³⁸ Roberts, *Joint Operating Agreements* (n3) 165.

³⁹ ibid 176.

⁴⁰ Unless a different method of allocation is agreed by the non-withdrawing members. OGUK §24.3(a).

⁴¹ Roberts, *Joint Operating Agreements* (n3) 165.

⁴² Andrews Kurth Kenyon LLP, 'UK: The Joint Operating Agreement'. Available at: <<http://www.mondaq.com/uk/x/298684/Corporate+Governance/The+Joint+Operating+Agreement>> accessed 29 May 2018.

⁴³ Roberts, *Joint Operating Agreements* (n3) 175. See AIPN § 13.2.A; OGUK §24.2.1.

exercise it.⁴⁴

For those reasons, the implementation of withdrawal in the JOA is widely debated. At best, such provision should be used with great caution and only in certain situations stipulated in the JOA.⁴⁵ For example, the JOA may require that withdrawal can be triggered after notice⁴⁶ and only with the consent of the State or competent authority.⁴⁷ It may also be required in the JOA, that the party wishing to withdraw has met its share of the work programme or budget at the time of notice.⁴⁸ If those conditions are not met, withdrawal will be ineffective and the withdrawing party will remain bound to the JOA.⁴⁹ If the JOA is silent about the conditions or requirements of withdrawal, the parties will need to consult the applicable laws of the relevant jurisdiction.⁵⁰

It might also be advisable that withdrawal be prohibited during certain periods which are crucial for the project, such as: the time until the meeting of the minimum work obligations under the licence,⁵¹ the period near the end of the project's life,⁵² the time during default of the withdrawing party,⁵³ or during emergency or *force majeure*.⁵⁴ Also, since withdrawal will affect the party's membership both to the consortium and to the underlying petroleum permit (e.g concession), it is important that the withdrawal provisions in the JOA consider the respective matters (e.g relinquishment of the concession area).⁵⁵

Liability is also important in withdrawal. Despite its exit from the JOA, the withdrawing party is likely to remain liable for its share of costs and liabilities, especially those which it approved before withdrawal (e.g unpaid minimum work programme).⁵⁶ It will also be liable for the costs associated with withdrawal (e.g stamp duties, transfer costs)⁵⁷ and for future costs stemming

⁴⁴ AIPN §13.1 and 13.9.

⁴⁵ Roberts, *Joint Operating Agreements* (n3) 175. See AIPN § 13.2.A; OGUK §24.2.1.

⁴⁶ AAPL JOA Model Form §17; AIPN JOA Model Form §13; AMPLA JOA Model Form §12; CAPL JOA Model Form §11; OGUK JOA Model Form §24.

⁴⁷ Norwegian JOA Model Form §24.1. Although, consent is not usually required as a party is free to withdraw. Roberts, *Joint Operating Agreements* (n3) 169.

⁴⁸ Gilbert & Tobin, 'It's not you, It's me...How to Exit from a Joint Venture and Still Remain Friends'. Available at: <<https://www.lexology.com/library/detail.aspx?g=78acda53-1f6e-4450-b515-1ca872be4680>> accessed 19 July 2018.

⁴⁹ Roberts, *Joint Operating Agreements* (n3) 169.

⁵⁰ Gilbert & Tobin (n48).

⁵¹ OGUK §24.2.1

⁵² *ibid* §24.2.3.

⁵³ AIPN §13.1.

⁵⁴ AAPL §17.3.3.

⁵⁵ Roberts, *Joint Operating Agreements* (n3) 166-169.

⁵⁶ Pereira et al, 'Default and its Remedies in the Context of the JOA' (n22) 17; King & Spalding (n35); AIPN §13.

⁵⁷ AIPN §13.6; OGUK §24.3; AMPLA §12.3(a).

from joint commitments which were made prior to withdrawal (e.g decommissioning costs).⁵⁸ For that reason, it is common that the withdrawing party provide a security (e.g corporate guarantee, bank letter) to the other parties covering any of those obligations to the extent it is applicable.⁵⁹

3. Interconnections

The previous paragraphs explained briefly the main features and the rationale of default, transfer of interest or rights, and withdrawal. This section will analyse the interconnection between these JOA provisions, *viz.*, their similarities and differences, their interaction, and compensation issues.

3.1. Similarities and Interaction

Default, transfer of interest or rights, and withdrawal are three distinct mechanisms. But at the same time, they share common features. The most obvious similarity is that all three mechanisms may cause the exit of a joint-venturer from the consortium. Also, the liability of the departing party is fairly similar (but not identical) in default, transfer of interest, and withdrawal. Any past cost, obligation or commitment prior to departure is likely to keep binding the exiting party regardless of the provision under which departure has been effected. However, this can be contracted out in the transfer of interest, where it is possible that all liabilities be transferred to the new party or that both parties be liable to certain extent and conditions.

In addition, all of these provisions will most likely deal with the relevant host government instrument and the host government. Commonly, the participating interest of the JOA parties and/or operatorship are subject to the host government approval and might not be effective until such approval is obtained. In other words, the existence of most JOAs is directly linked with the respective host granting instrument, even though the JOA could survive for a longer period, *viz.*, until the consortium's outstanding obligations and/or payments are settled. In this case, a complex situation may arise if a party's voluntary or involuntary removal from the JOA is not eventually approved by the host government under the host granting instrument. Such entity would have no rights under the JOA but remain bound by the host granting instrument.

⁵⁸ Taverne, *Petroleum, Industry and Governments* (n37) 379. By contrast, the withdrawing party will lose its entitlement to any petroleum produced after the effective date of withdrawal, as well as its voting rights to OpCom and the right to receive information. AIPN §13.1-13.3.

⁵⁹ King & Spalding (n35).

Some JOAs might address this issue by revoking such departure or forcing the departing entity to behave in a certain manner.

Finally, although default is distinct from both transfer of interest or rights and withdrawal, there is a legal interaction between those mechanisms. Each pair will be discussed in sequence.

With regards to default and transfer, their interaction is identified at two levels. First, transfer may lead to future default, after the completion of the transaction, if the assignee is of limited creditworthiness.⁶⁰ To avoid default, the assignee may provide evidence that it can satisfactorily meet its financial obligations, such as corporate guarantee by the parent entity. However, as previously mentioned, the JOA may require that transfer be subject to the consent of all remaining co-venturers.⁶¹ If such conditions are not met, then transfer will not be effective. Second, this interaction continues even during default. During that period and until the remedy of default, the defaulting party may be deprived of the ability to assign its participating interest in the JV.⁶² This represents “a drastic curtailment of the options available to that party since, theoretically, the ability to dispose of its share might be one option for resolving the default.”⁶³

A dual interaction also exists between default and withdrawal. First, the JOA may provide that the party wishing to withdraw must provide the remaining co-venturers payment in immediately available funds to satisfy any financial obligations which were approved or accrued prior to withdrawal. This will protect the members of the consortium from a potential default, especially when the withdrawing party holds the largest participating interest (e.g the operator). Second, a prohibition of withdrawal may be imposed during actual default. In that case, a limitation on the right to withdraw can be perceived as “an important restriction on the defaulting party, which might have wished to withdraw due to belief that the underlying economics of the particular project no longer served its interests.”⁶⁴

3.2. Differences

In all three situations (default, transfer of interest/right, withdrawal), the ultimate consequence would be the same, *viz.*, a party’s exit from the consortium. But by whom, why, and how this is effected is different.

⁶⁰ Andrews Kurth Kenyon LLP (n42).

⁶¹ *ibid.*

⁶² See AIPN §8.2; OGUK §17.5.

⁶³ Pereira et al, ‘Default and its Remedies in the Context of the JOA’ (n22) 17.

⁶⁴ *ibid* 18.

The first question refers to the entity (-ies) which may trigger such exit. In default, the removal of the defaulting party is likely to be initiated and forced by the non-defaulting parties. This is different from the transfer of interest and withdrawal, which are exercised voluntarily by the departing party.

The second question refers to the reasons behind this exit. A default and withdrawal are more likely to happen whenever the project possess a negative or low commercial value. By contrast, a transfer of interest is more likely to happen when a project has significant commercial value. Also, withdrawal is the only option which is less likely to secure any compensation to the departing member as it will be explained below.

The third question concerns the implementation of the respective exit mechanisms and their consequences for the departing party. Although withdrawal and transfer of interest appear to be very similar, in that the concerned party will voluntarily leave the consortium but remain liable for certain obligations which have accrued prior to its exit, they have two main differences as well. First, the withdrawing party will not receive any consideration for its divested interests.⁶⁵ Second, in withdrawal, the remaining parties will always be the receivers of the departing party's interest.⁶⁶ Also, although default may lead to the party's forcible withdrawal from the JOA, this process is not identical as in conventional (voluntary) withdrawal. In default, the departing party is less likely to be obliged to remove any encumbrances over its interests nor to provide a decommissioning security, whereas such obligation exists in withdrawal.⁶⁷

4. How do they all Fit Together?

The previous paragraphs explained briefly the main similarities and differences among default, transfer of interest or rights, and withdrawal. Yet, the most crucial question is: how do they all fit together into one agreement? Are they consistent? Is it fair their how they treat similar issues? Are they overlapping or even conflict among themselves? The next sections will analyse in details the reason why they all have their own purposes and how could fit all together under the auspicious of the same agreement.

4.1. Is it Fair to Receive Compensation in a Default or Transfer but not in Withdrawal?

As seen in Section 2.2, transfer of interest or rights in the JOA is essentially a sale, hence it

⁶⁵ Roberts, *Joint Operating Agreements* (n3) 174.

⁶⁶ *ibid* 175.

⁶⁷ *ibid* 224.

might be subject to a monetary consideration. That way, the transferor will be compensated for the value of its participating interest which assigns to another party or at least it might assign free of costs the related liabilities to a third party. To that extent, no issue should arise about the justification of the departing party's compensation and/or its release from the all or certain liabilities.

However, things are more complex in the other two exit mechanisms. Commonly compensation might be payable to the defaulting party but not to the withdrawing one.⁶⁸ On the face of it, this discrepancy may seem to be striking. A default may eventually lead to a compulsory withdrawal, as it will cause the defaulter's forcible exit from the JV and allocation of its participating interest to the remaining parties. To that extent, it might be *prima facie* assumed that a defaulter should not be entitled to compensation, just like the withdrawing party will not receive any money for leaving the JV.

From a pragmatic view, though, it can be argued that the above analogy between default and withdrawal is not entirely appropriate or practical. In law, only "comparables" can be effectively compared. In other words, the only elements which can be comparatively analysed are those that fulfil the same function. As seen in sections 2 and 3 above, the mechanisms of default and withdrawal are quite different, in both their purpose and outcome: default seeks to address a challenging situation where a member of the JV is commonly unable to meet its financial commitments, whereas withdrawal is a voluntary right exercised anytime (unless otherwise provided in the JOA) during the life of a JV. Likewise, default might lead to a forcible ejection of a member from the JOA and taking of its participating interest by the remaining parties, whereas withdrawal is the voluntary exit of a co-venturer which leads to abandonment of that party's rights and future duties.

Therefore, their basic purpose is different as the default aims to secure the unity and financial commitments of the JOA parties while the withdraw aims to secure the departure of a JOA party. Their procedures are also different as a defaulting party cannot leave the agreement while a non-defaulting party might be able to leave the agreement. In addition, a defaulting party is likely to be exiting the JOA involuntarily while the withdrawing party is more likely to be exiting voluntarily.

These differences between default and withdrawal justify their different linkage to

⁶⁸ See Sections 2.1 and 2.3.

compensation.

Compensation in default is might be reasonable, as it mitigates the threat (*“in terrorem”*) of full forfeiture after a significant investment and/or value has been made.⁶⁹ That way, a balance can be drawn between the interests of the non-defaulting parties, which bear the task to preserve the JV post-default, and the defaulter, which might forcibly lose its participating interest and all associated rights (e.g voting rights, production share) in the consortium. Compensation in the context of default should by no means be considered as a *“bonus”* or a *“gain”* of the defaulter but as an equitable relief. That is not only fair but also essential, especially in situations where the defaulter has paid a vast amount during its participating in the JV but is unable to pay a relatively smaller cash call. The court will determine whether *“the nil price”* or *“a small fraction of the price”* paid for forfeiture of the defaulter’s interest is *“exorbitant or unconscionable”* and award compensation to the party if deemed necessary.⁷⁰ To that extent, a party’s exit from the JOA in the context of default is more akin to a *“forced transfer”* (if an analogy should be made) than to withdrawal.⁷¹

By contrast, such equitable relief is unnecessary in the context of withdrawal. Unlike default, which might lead to forcible ejection of a party from the JOA, withdrawal is usually a purely voluntary exit. The withdrawing party has decided itself to abandon the consortium (which may be effected at an acceptable time for the project) and therefore it should not receive any compensation for that. Besides, the withdrawing party has typically the right to receive its entitlement of hydrocarbons produced by the effective date of its withdrawal. To that extent, (an additional) compensation post departure would be unnecessary.

However, it is possible to argue that, in specific circumstances, a JOA party might be indirectly *“forced”* to withdraw from the consortium without its pure desire to do so. For example, that might be the case if sanctions were imposed to the company by the host government. Nevertheless, it is still up to such JOA party to comply with the said sanctions or remain in the consortium and challenge them.

Finally, to suggest that compensation should be excluded from default because it is simply not available in withdrawal (which is a completely different situation to default) is not consistent

⁶⁹ Pereira, ‘Protection Against Default in Long Term Petroleum Joint Ventures’ (n18) 24.

⁷⁰ Berwin Leighton Paisner, ‘Oil & Gas JOA Defaults: Enforcing Forfeiture Clauses after the Cavendish Square Decision’ available at <http://www.blplaw.com/media/how-can-we-help-you/finance/Oil_Gas_JOA_Defaults_-_Enforcing_forefeiture_clauses_after_the_Cavendish_Square_Decision.pdf> accessed 29 May 2018.

⁷¹ *ibid.*

with the industry practices. The defaulter's right to receive compensation for its investment and its ability to meet its financial obligations in the JV prior to eviction is justified and undeniable, otherwise several JOA Model Forms would not offer a buy-out, withering or lien default remedies. However, it is reasonable to recognise that certain restrictions should exist in the amount which the defaulter would receive. The defaulter's compensation should be subject to its participating interest, the amount of the unpaid cash call for which default was triggered, and possibly a reasonable discount. In the context of a commercial or contractual dispute, this can only be determined by the competent court or tribunal.

Based on the above, it is fair for a departing member to receive compensation in the cases of default and transfer of interest, whereas no such compensation is justified in withdrawal.

4.2. Would a Default Provision Prevent or Encourage a Party's Voluntary Exit?

It is possible that, in a given moment, a JOA party is no longer keen to remain in the consortium and decides to leave the JV. The main questions that would follow are: (i) is this possible, and (ii) how could this happen?

Assuming that all minimal work obligations have been performed and there is no default in place, then there should not be any issue to perform such voluntary departure. But the next question is how? Should the party depart with or without compensation? Logically, such party would prefer to transfer its interest to another party, so it could monetize some value out of its participating interest rather than simply withdraw without any compensation or at least assigning its liabilities to a third party. However, if the party fails to find a suitable buyer for its desired transfer of interest, it could seek a "perverse" solution to receive compensation. Such JOA party could "force" itself into a default situation and hope that the other JOA parties would enforce the default mechanism and end up taking over its participating interest under certain compensation (i.e. forced departure of the defaulting party).

Although this hypothesis is *prima facie* possible, it is less likely to be successful for the following reasons. Firstly, if there is no market value for such participating interest to proceed with an assignment, then it is less likely that compensation would be payable. Secondly, it is important to understand the default remedies and the applicable law. For example, a proportional dilution could be in place and frustrate any possibility of compensation. Thirdly, the non-defaulting parties could decide to only employ certain procedures of the default provision (e.g. suspension of defaulter's voting rights in the Operating Committee and/or sequestration of production) without actually ejecting the defaulting party. In this case, the

defaulting party would only suffer losses and increase its liabilities but no compensation or benefits and lose the ability to control its departure of the consortium.

In sum, although the default provision could primarily encourage a party to withdraw from the JOA *and* receive compensation, the implementation of this option is not necessarily feasible nor practical.

5. Conclusion

As most contracts, JOAs bear various clauses. These regulate the relations of the parties *inter se*, their rights and obligations, and the exit of parties from the consortium. Although each provision of the JOA serves its own purposes, it also connects to the entire agreement. That is the case with default, transfer of interest or rights, and withdrawal. At first glance, these three mechanisms appear to be entirely distinct. Default responds to a problematic situation which commonly arises from the failure of a JOA to pay its share of costs. It is typically forced by the non-defaulting parties and may result to the suspension of the defaulter's rights and eventually, sequestration of its participating interest. Transfer on the other hand, is a voluntary assigning of a member's participating interest in exchange for a monetary consideration. Finally, withdrawal is also voluntary but leads to the surrender of a member's participating interest free of cost.

Yet, a closer look reveals that these three mechanisms also share common features, the most important being the exit of a party from the JOA. This enables the comparison of the above clauses with regards to certain aspects, such as the compensation of the departing party and its liability after exiting the JOA. The answer to these questions may ultimately determine the consequences of an "exit strategy" if a member wishes to leave the JOA.

The study revealed that liability of the departing party is almost similar (although not identical) in all three mechanisms. Any cost, obligation or commitment to the JOA prior to departure is likely to keep binding the exiting party regardless of the provision under which departure has been effected (default, transfer, withdrawal), although a different arrangement can be made in the case of transfer. By keeping the departing party liable for pre-existing costs, the JOA seeks to prevent its members from simply abandoning their obligations at the expense of the remaining parties. Although exit (voluntary or forcible) from the consortium is generally allowed, it should not jeopardize the life of the JV. The above must be considered by prospective joint-venturers when drafting and negotiating the provisions of the JOA, and from existing members that plan to exit the JOA.

By contrast, compensation is granted only in transfer and may also be payable under certain conditions in default, but not in withdrawal. The reason for this divergence is the different purpose that each mechanism serves in the JOA. In transfer, the money and/or the assignment of liabilities which the departing member will receive and/or assign (as the case might be) is the consideration for the allocation (i.e. selling) of its participating interest to a third party. In default, the compensation which the departing member may get is essentially an equitable relief for losing its investment to the consortium. Neither of the above legal grounds are met in withdrawal, which is the voluntary abandonment of the JV by a member which no longer has the same interest in the project as in the beginning.

Nevertheless, it is possible to suggest that certain JOA parties might desire to “abuse” a given contractual position to the detriment of the consortium and/or their fellow “partners” in order to seek a more beneficial departure, (i.e. “strategic exit”), even though such reprehensive decision might come with its own costs and risks as well. For instance, a party willing to leave the consortium but unable to transfer its interest under the existing circumstances may force itself to default, hoping that it will be ejected by the other members with compensation. However, such attempt may be eventually doomed to failure by the applicable law or the case facts, or if the other members decide to enforce a different remedy to default.

The above details must be carefully considered by a JV member that seeks to leave the consortium. Each of the three exit strategies (default, transfer of interest or rights, withdrawal) may have different consequences for the invoking party *per se* and for consortium in total.