

JOINT VENTURE OPERATING AGREEMENTS

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Joint Venture Operating Agreements are widely used in New Zealand for regulating the relationships between co-explorers under a single licence and providing a mechanism for exploration operations to be conducted in an orderly way. Joint ventures must be distinguished from other legal arrangements to avoid unwanted liabilities and restrictions.

The operator appointed by the participants is subject to the Joint Venture Agreement and also to obligations on good faith and business ethics.

The choice of a joint venture structure, instead of the alternatives, can have consequences for the parties under Income Tax legislation, responsibilities for costs and relationships with outside contractors.

Participants with different backgrounds (financial, technical or national) seek different terms in their Joint Venture Agreements, to reflect their own priorities.

Some of the more important features of Joint Venture Operating Agreements are reviewed, including default mechanisms, the effect of assignments and withdrawals, arrangements for development and production, participation by the Crown and the reporting and accounting procedures.

INTRODUCTION

Joint Venture Operating Agreements (JVOAs) are widely used in New Zealand for regulating the relationships between participants in the petroleum industry operating under a single licence and for providing a mechanism for exploration operations to be conducted in an orderly way. The legal and commercial considerations relevant to Joint Venture Operating Agreements are numerous and frequently the subject of disagreement. I propose to comment on a number of matters which I believe will be relevant to anyone with a commercial or legal interest in exploration projects in New Zealand. Many of these topics have been covered in more depth elsewhere and I have included a list of suggested further reading at the end of the paper.

I propose to start by considering the nature of a joint venture and some of the legal concepts relevant to that. Next, I will comment on why, generally, a joint venture remains the most suitable form of business arrangement for petroleum exploration and consider some of the potential and actual disadvantages of that form. After that I will comment on some of the main characteristics of Joint Venture Operating Agreements and the issues which arise in negotiating those Agreements, operating under them and regulating the relationships of the parties, (including the Crown and its position) under the range of operational and commercial circumstances which can influence the course of a petroleum project.

What is a joint venture? For the purposes of this paper, I refer to a joint venture as that relationship which exists, by virtue of a formal agreement, between several parties who are all

licensees under a petroleum licence and who have entered that agreement for the purpose of co-ordinating their efforts through an exploration programme and any other work to be done under the licence. The expression *joint venture* is used for describing many other co-operative enterprises, regardless of the precise legal structure. I do not propose to deal with those here.

The important elements of the type of joint venture I am describing include the following:

- (a) It is a form of association established by agreement between the parties.
- (b) It is not a company, and therefore is not a separate legal entity from the participants. It does not incorporate a ready-made code, such as the Companies Act and does not have a capital structure which is subscribed to by the participants.
- (c) It is not intended to be a partnership. The distinctions between partnership and joint venture are discussed further later in this paper.
- (d) The participants own the assets which are used by the joint venture in defined proportions, as tenants in common.
- (e) The agreement includes mechanisms for co-operative operations to explore for and develop petroleum and exploit the assets of the joint venture.
- (f) An operator is appointed, who may be a joint-venture participant or another party, (to conduct operations, make commitments and incur expenditure on behalf of the participants).
- (g) The terms of contribution, decision-making, participation in the benefits of the joint venture project are recorded in the agreement.

- (g) There is an acknowledgement that the objective of the project is to produce a *product* which will be owned by the participants in kind.

To understand the legal significance of some aspects of joint ventures, it is necessary to understand some legal jargon. The most important matters are:

Joint ownership or a joint tenancy means the form of co-ownership of an asset in which the owners act as one. No owner can deal with its interest separately from other owners nor without the consent of the other owners.

Ownership in common or a tenancy in common is the type of co-ownership in which each party has an undivided share in an asset, and may not deal with it in a manner inconsistent with the interest of the other co-owners. However, each party can deal with its individual interest without the need for the other parties to agree.

Joint liability is the liability or potential liability of two parties to another party, which enables that other party to sue either or both of those who are jointly liable for the whole of the liability.

Several (or separate) liability is the liability which can only be enforced separately against the separate parties which are liable, to the extent of their individual liabilities.

Joint venture companies and incorporated joint ventures are loose expressions for various arrangements which are legally companies, possibly supplemented by an agreement between the shareholders about the way in which they will cause a company to operate. We are not concerned with them in this paper except possibly in a limited sense. That is the sense in which a joint venture company is sometimes established as a bare nominee or trustee for the joint venture participants, to be the operator for the joint venture. Where this mechanism is used the joint venture is almost identical to that under our usual joint venture operating agreement, except that the joint venture company can provide a corporate image which is different from any single one of the joint venture participants.

Joint venture partnership I believe this expression is used in America. It should certainly not be used in New Zealand for anything which is not a partnership, and is unnecessary and unsuitable to describe a partnership.

Partner is a member of a Partnership. It should not be used to describe a participant in a joint venture, because that suggests that there is a partnership. Partnerships are explained more fully in the next section.

Fiduciary duty is the duty owed by a fiduciary to some other person. It is the type of duty which the trustee owes to the beneficiaries of the trust. It means that the trustee may not profit from the use of property, information or opportunities which become available to it in the course of its activities as trustee, without passing the profits to the beneficiaries. A trustee can be required to account to the beneficiaries for profits which the beneficiaries themselves could not have gained, even if they had been aware of them. The relationship is not restricted to trustees. Partners owe a fiduciary duty to each other and agents commonly owe a fiduciary duty to their principals.

JOINT VENTURE OR PARTNERSHIP?

A partnership is a recognised form of legal association. By virtue of the Partnership Act 1908, Section 4(1) a partnership is *the relationship which subsists between persons carrying on a business in common with a view to profit*. This definition is important for two particular reasons:

- (a) A partnership will come into existence if that relationship arises, regardless of how the participants themselves describe the relationship.
- (b) If the relationship arises then the whole of the law of partnership will apply to regulate the relationships between the partners themselves, and the relationship of the partners with third parties (i.e. anyone outside the relationship).

For our purposes, there are several significant characteristics of a partnership which the parties to a joint venture operating agreement will wish to avoid. Those are:

- (a) Every partner will be jointly and severally liable for the debts of the partnership. A third party claiming against the partnership can enforce the claim against any partner, leaving that partner to collect from the others if it can do so.
- (b) Each partner is the agent of every other partner. This means that a participant who makes a commitment on behalf of the partnership will bind the partners to perform that commitment as far as outsiders are concerned (regardless of whether the constitution of the partnership limits that authority or not). Joint venture participants will generally require that only the operator has that authority, to be exercised strictly in accordance with the terms of the authority given by the joint venture operating agreement and the instructions of the Operating Committee.
- (c) Each partner is in a fiduciary relationship to the other partners. This means that generally, a partner may not profit from the use of property, information or opportunities which become available to it in the course of partnership activities without making available to the other partners a share in the benefits.
- (d) In New Zealand, every partnership is a separate business for tax purposes, although the net profit or loss is attributed to the partners in agreed shares. This means that a single set of accounting policies must be established for tax purposes. Individual partners cannot adopt their own policies for capitalisation of expenditure, depreciation or other discretionary matters.

WHY A JOINT VENTURE?

The commercial and legal circumstances of petroleum exploration mean that every type of business association or structure has some disadvantages. The features which characterise the industry include:

- (a) The diversity of participants, with different nationalities, different degrees of *risk aversion*, different financial strengths, different levels of expertise, different requirements for financial reporting and tax accounting.
- (b) The need to share the risks (and consequently rewards) of a high cost, high risk industry by co-operating within licence areas rather than individually exploring separate licence areas.
- (c) The need of participants to adjust their interests in the venture from time to time, as the project proceeds or

- financial or technical circumstances change.
- (d) The need of participants to delegate the operating function, subject to suitable controls and supervision.
 - (e) The need of participants to insulate and spread the risks of accident or default, including accident to or default by the operator.
 - (f) The need to continue a project even if a party fails or withdraws (including by means of sole risk).
 - (g) The need to provide a basis for commercial development of any discovery.

Some of these objectives could be met by other structures, such as a company, a partnership or a limited partnership. However:

- (a) During the exploration phase, when a loss is quite likely, there is no satisfactory way of passing the losses back to the participants from a company.
- (b) None of the other structures permit the participants to have the freedom of adopting their own accounting policies on a *line by line* basis, both for tax and financial accounting purposes.
- (c) As the joint venture relationship is almost entirely defined by the contract (the JVOA), the parties can incorporate whatever provisions they wish to deal with decision-making procedures, authorities, assignment of interests, defaults and other arrangements.
- (d) The parties can (probably) exclude the features of a partnership, such as the fiduciary relationship, the authority of any participant to bind the others and the consequences of unlimited joint and several liability.

PROBLEMS OF A JOINT VENTURE

Although the joint venture structure seems to be the best available for the particular characteristics of the industry, it does have some shortcomings. Some of these are characteristics of the structure itself, while others arise from the doubt about its legal character.

An important concern is whether a joint venture, as we know it, really exists separate from partnership. My own view is that it can exist, but it must be nurtured. It is not sufficient simply to include a provision at the back of the agreement denying the existence of a partnership, if the rest of the agreement is more consistent with a partnership and the parties conduct themselves as a partnership. A participant or a third party may wish to characterise the arrangement as a partnership to enforce a fiduciary obligation, joint and several liability on a claim or to enforce some commitment which would otherwise be outside the authority of the participant who may have made it. For those reasons:

- (a) Participants should never be described as *partners*.
- (b) The interest of the parties in any production must be in kind.
- (c) The operator should keep separate accounts for the joint venture, from which the separate share of each participant can be identified at any time.
- (d) Cash flows must be accounted for as receipts and payments, and never as *profit*.
- (e) For preference, there should be no reference to joint assets or joint accounts. Certainly the expressions should be defined in the JVOA to make it clear that they are not truly jointly owned assets but held in common.

In dealings with third parties, the joint venture structure can be confusing, if not dangerous. The operator must avoid any suggestion that it is acting as agent for a group of principals

who are in partnership. The operator may act purely on its own account, seeking reimbursement from and accounting to the other participants. This is not a usual method in New Zealand. More usually, the operator discloses that it is acting as an agent for a joint venture. In my view, joint ventures are sufficiently widely used and well known in petroleum exploration in New Zealand that a third party claimant would have some difficulty arguing that it thought it was dealing with a partnership.

After exploration, in the development and production of a discovery, the joint venture structure can be very cumbersome for financing on a stand-alone project basis. However, it may suit all the participants to reconstitute their arrangements at that time to some more suitable vehicle, such as a company. If a project is profitable, there is less need for the ability to allow participants to deduct losses. The corporation would also enable the participants to convey a project image rather than that of the operator.

Even if the joint venture is not a partnership, there may still be a fiduciary relationship between the participants. This proposition has arisen from cases in Canada and Australia over the last few years, although none of them are strictly on point with the type of joint venture agreement used in the petroleum industry. The Australian judges, in particular, seem to have failed to discriminate between a partnership and a joint venture as we know it (relying instead on some American concepts of a joint venture). The current position seems to be that:

- (a) During the course of contractual negotiations, certain fiduciary obligations may arise. These impose on the parties an obligation of good faith towards each other in making representations about the commercial arrangements to be entered into, information about the licence and such matters. Conversely, information made available in these negotiations may not be turned to profit by the recipient for any other purpose.
- (b) Even after a joint venture has been entered into, notwithstanding that the existence of a partnership and fiduciary obligations are excluded, there may still be an obligation of good faith (which has been described as a fiduciary obligation) between the participants.

In my view, this latter point is not certain. Certainly, there is some duty of care and of good faith. Lies, misrepresentations and breaches of confidence are not acceptable, but the parties commonly do not expect to observe the full burden of fiduciary obligations. It seems quite unsatisfactory that a Court should seek to characterise a relationship entered into between companies, at arms length, in a way different from what the parties clearly intended. There may be some clarification of this in the claim over the Ngaere licence. I would certainly welcome that, particularly if the Court provides the right answers.

If there is a fiduciary duty on joint venture participants, then it seems likely that the duty will be owed to the other participants individually and to the joint venture as a collective whole.

PETROLEUM JOINT VENTURE OPERATING AGREEMENTS

From the general discussion of joint ventures, we may now turn to the Joint Venture Operating Agreement. Generally, this agreement will establish the joint venture arrangements

and the rights and obligations of the parties and will also record the means of appointing an operator and the rights and obligations of the operator (as distinct from its capacity as a joint venturer, if it is one).

The JVOA will generally provide for:

- (a) A statement of the scope, purpose and duration of the Agreement.
- (b) A statement of the parties' interests and how assets held for the purposes of the joint venture will be owned.
- (c) Rules and procedures for the operation, management and control of the venture.
- (d) Procedures for the contribution, holding and expenditure of funds, including accounting and reporting obligations and audit requirements.
- (e) Provisions for the apportionment of liabilities between participants and the consequences of default.
- (f) A regime for the taking in kind and disposing of production.
- (g) Mechanisms for the assignment of interests, withdrawal by participants and termination of the agreement.
- (h) Provisions for dispute resolution, governing laws, notices, confidentiality and other machinery provisions.

I do not propose in detail with all of the possible provisions of a JVOA. You will no doubt have your own samples, but I would also commend the guidelines for an exploration joint operating agreement published by the Australian Petroleum Exploration Association Limited (APEA, 1984). There are, however, a number of areas of importance in almost every JVOA, which are worth noting.

PARTIES' INTERESTS

Note that the parties' interests are not in the joint venture but in the rights and obligations which are created by the JVOA, in percentage shares, as tenants in common. The parties also have an interest under the licence, which should be referred to in the JVOA for consistency, but is in fact a separate interest. By virtue of the Petroleum Act, the interests of the licensees are joint and several, which means that all named licensees can be held responsible for any failure to meet the obligations under the licence.

MANAGEMENT AND CONTROL

Management of the joint venture is generally through an Operating Committee, established by the agreement. Usually the parties are entitled to appoint a representative to the Operating Committee, who exercises a vote proportionate to that party's contributing interests in the project under consideration. It is common (though not universal) to have a minimum voting interest set at about five percent. Parties with less than a five percent interest may aggregate their interests or join with another party for representation and voting.

It is usual to provide that any proposal to the Operating Committee will only be passed if supported by a specified majority, usually in the range of 65 to 80%. The figure will usually be negotiated to achieve a balance between leaving one party with a power of veto (if it holds more than the difference between the majority and 100%) and forcing one or more minority parties into a proposal which has only moderate support.

Usually, certain decisions require the unanimous support of the parties, including any decision to surrender or terminate the licence.

APPOINTMENT OF OPERATOR

The first operator is generally appointed when the Agreement is executed, or before. Usually an operator can be removed if it fails to meet its obligations or becomes insolvent and often if its interest falls below a certain level. It may resign and commonly (though not always) may be removed by a majority vote of the other participants.

The operator will generally be indemnified for all costs and liabilities which it incurs on behalf of the joint venture, unless the operator's performance is well below standard. Various criteria are used, the most common ones being *wilful misconduct* or *gross negligence*.

Obligations of the operator to undertake the work and report to the participants are set out, including a process for approving budgets for particular work programmes, approving *authorities for expenditure* as a basis for cash calls and a process for committing to major expenditures with requirements for competitive tenders and reporting to the participants. Generally, it is consistent with the spirit of the venture that participants will be entitled to all information available to the operator. However, the amount of information which will be regularly provided will depend upon the particular operator and other participants in each case. Operators, especially larger companies accustomed to budgeting on a grand scale, will seek to include high thresholds for discretionary expenditure by the operator and no more detail than they use in their internal reporting. Smaller participants, especially non-operators, will be anxious to contain their exposure to unanticipated expenditure and will seek more detail in the reports.

The operator will perform its functions by engaging its own staff (or staff of affiliated companies) on the operations of the joint venture as well as contracting services from outside consultants and contractors. Payments to third parties will be accounted for within the joint venture and reimbursed by the other participants, but there is always some sensitivity about reimbursement to the operator. It is acknowledged in many agreements that the operator will neither gain nor lose money by performing the functions of operator, and it is necessary to devise a formula which will reimburse the operator for its internal staff time, both direct and indirect, and including all office and operating overheads provided as a resource to the joint venture. The usual bases include:

- (a) Direct *time-writing* by staff engaged for significant periods directly on the project, whose time will be charged to the project at a daily or hourly rate which is intended to cover the cost of the operator of their employment.
- (b) A charge for overhead recovery, usually based on a percentage (often on a graduated scale) of the expenditure incurred on the operation.

Obviously, the negotiation and functioning of these methods demand a level of candour between the participants and the operator when they are being settled. The pricing structure for a small operator which mostly employs outside consultants will be different from that of a large company with an extensive technical support force.

In many cases the operator is also a participant, so it functions in a dual capacity. This must create obligations on the operator to deal fairly with all participants, and not allow its own interest as a participant to prevail. In general, it is probably true to say that the operator is the agent of the other participants in all of its operations, certainly with respect to its relationships with third parties. That is often specifically stated in the JVOA. A contract of agency usually carries with it fiduciary duties on the part of the agent to its principal. Thus, regardless of whether there is almost a fiduciary relationship between the joint venture participants as joint venturers or as partners, there is almost certainly that sort of obligation imposed on the operator as their agent.

OPERATING PROGRAMMES AND BUDGETS

The JVOA must include a mechanism for preparing and agreeing upon work programmes and budgets. The amount of detail which needs to be included in the agreement will depend upon the wishes of the parties. Most JVOAs in New Zealand include a series of time frames for submitting proposals to the participants, convening operating committee meetings and adopting proposals which will then be binding on the parties. In setting the various time intervals, the needs of all participants must be accommodated. The parties will need to consider:

- (a) The time needed to prepare proposals by the operator.
- (b) The reasonable time for other participants to consider them, bearing in mind the resources and bureaucratic processes of each participant.
- (c) The need to co-ordinate the timing for decisions with the periodic work obligations imposed under the licence.
- (d) Sufficient time for any participants who are unable or unwilling to participate in an approved programme to follow whatever other courses are available to them under the JVOA (e.g. assignment, withdrawal, non-consent).

NON-CONSENT AND SOLE RISK

Non-consent and sole risk provisions in JVOAs frequently absorb a lot of attention in the negotiating process, although they are relatively rarely implemented. Most New Zealand agreements include sole risk provisions, though non-consent provisions are less commonly used here. Both can be included in the same agreement, of course, as in the case of the APEA guidelines (APEA, 1984).

It must be remembered that both sole risk and non-consent provisions generally apply to *discretionary* work programmes; that is, proposals for operations which are in excess of the minimum work obligations required under the licence.

A non-consent provision permits a party or parties to remain outside a particular programme, even though the programme has been approved by the relevant majority of the operating committee and would otherwise be binding on all participants. Thus, a party who is unwilling (on technical or financial grounds) to support a programme may remain outside it. Usually, if several parties choose to remain outside it, the economics of the proposal may be so modified that it needs to be reconsidered.

Sole risk is almost a mirror image of non-consent. If a party wishes to undertake a programme which does not have the

support of the necessary majority in the operating committee then it may be permitted to do so at its own risk and expense. There will be a number of conditions to be met by a party which seeks to proceed at sole risk, including:

- (a) The proposal must be offered to the other participants, who may choose to join it.
- (b) The proposal must be limited in scope and not in conflict with any approved or obligatory programmes.
- (c) The other participants will be entitled to rejoin the programme at a later date, if they wish, upon committing a premium contribution to the costs to be allocated from production.
- (d) All information generated from the sole risk operations must be made freely available to the other participants.

DEFAULT

The possibility of default by a participant and the mechanisms available to deal with it lead to a number of difficult legal and commercial issues. The parties involved in an expensive exploration project have an interest in ensuring that each party contributes its due share. Any failure to do so may put the programme in jeopardy or cause great difficulty to other participants who may be called upon to make up the shortfall at short notice. At the same time, some accidental or organisational delay in payment should not necessarily result in a party being excluded from further participation.

Several devices have been used to deal with the possibility of default, each with their own advantages and disadvantages. They include:

- (a) Forfeiture of the defaulting parties interest (or forced withdrawal by the defaulting party).
- (b) Abatement or dilution of the defaulting parties interest, usually to reflect a multiple of the shortfall in contributions.
- (c) The loss or suspension of rights to production.
- (d) Rights exercisable by the other participants who have contributed to shortfall, claims for debt including charges over the interest and possibly other assets.
- (e) Rights of purchase by the other participants of the defaulting party's interest.
- (f) Liability to pay interest on the shortfall.

More than one of these elements may be present in any JVOA, but caution must be exercised where the default results in a complete forfeiture of an interest or an excessive penalty. The law will permit the parties to agree upon remedies for a breach of contract which compensate for the damage caused and return the non-defaulting parties to their original position. However, provisions which have no justification except as penalties may be unenforceable and in certain circumstances a defaulting participant may be able to claim relief from forfeiture of an interest under the rules of equity.

In the case of an exploration joint venture, which is put severely in jeopardy by a default and cannot be satisfactorily financed except by the participants, the Court is less likely to be sympathetic to the defaulting participant than in the case of a development or production arrangement where a financial adjustment may solve the problems. The Courts are likely to be sympathetic to the defaulter if an interest is forfeited solely for failure to meet some time constraint.

These issues create a tension between:

- (a) The need for certainty and availability of funds for operations.
- (b) Preventing a doubtful participant from delaying during the course of operations to see the result.
- (c) The interests of a party which has suffered some temporary management problem which can be remedied.

PRODUCTION AND DISPOSAL OF PETROLEUM

The short term focus of most New Zealand JVOAs has been on exploration. The treatment of development and production has varied, from a short provision which calls upon the parties to negotiate with best endeavours if a discovery is made, through to a reasonably comprehensive *Heads of Agreement* for a development and production joint venture, including obligations by the parties for uplifting petroleum.

For the reasons I have already described, the JVOA should at least include an agreement that any petroleum will be shared by the participants in kind. Beyond that, it is impossible to be certain what sort of development or production programme might be required and whether indeed the normal exploration joint venture structure is going to be suitable for the financing and operational requirements of development and production. However, I think it is still useful to include some provisions which recognise the possibility of development and production and which lay the framework for a decision-making process to be employed at that time.

Those provisions need to be integrated with the arrangements under the JVOA for considering and agreeing upon a development proposal and mining licence applications, including the possibility that not all parties may wish to participate.

WITHDRAWAL AND ASSIGNMENT

It is generally recognised that a party which does not wish to continue in the joint venture should be free to extract itself, on suitable terms. However, every party does assume some obligations by its initial agreement to participate and every other party will make decisions in the expectation that all participants will perform their commitments. Obviously, the contribution and exposure of each remaining participant will have to increase if the programme is maintained after the withdrawal of any party. In addition, the parties are jointly and severally liable for the obligations to the Minister under the licence, and that may include obligations to meet environmental or abandonment costs.

In these circumstances, a party which wishes to withdraw must generally meet the commitments it has already made, including commitments to which it is bound by a decision of the Operating Committee, even though it may have voted against those decisions at the time. The only exception to this commitment is generally a window of opportunity to withdraw after the Operating Committee has approved a work programme by a decision binding on the parties, but before it has committed that work programme to the Minister to become a licence obligation. The withdrawal mechanism must then provide for all current obligations to

be met and for each other party to consider its own position in the light of the reconstituted joint venture.

The other method for a party to reduce its commitments under the licence and the Operating Agreement is to assign its interest to one or more existing participants or an outside party. Because the fortunes of the participants are so closely linked and they rely so much on each other there is always some mechanism which limits the parties' right to assign an interest. The mechanisms used are similar to those in closely held companies and in partnerships, although there are a certain number of variations.

The most common arrangement is a pre-emptive right, which compels any proposing assignor to disclose to the other participants its intention to sell its interest and the price it is seeking. The price may reflect an actual third party offer, but if it does not, then the other participants must have the right to delay the exercise of their pre-emptive right until they can be satisfied that they are not being asked to pay more than an independent third party is willing to pay.

I believe it also follows from the nature of the joint venture that the existing participants must be entitled to consider whether a proposed assignee is acceptable as a participant. Commonly there is a requirement that the assignee must be financially competent (which the assignee must establish to the satisfaction of the other participants). In some cases the other participants may wish to exclude a proposed assignee without the need to give reasons.

A balance has to be reached between the interests of a party which wishes to have a freedom to sell its asset at the best obtainable price and the interests of other participants who wish to be assured of competent and congenial company in the joint venture.

There are of course various ways of transferring the effective value of an asset, and it has now become common to include prohibitions on the sale of shares in companies, which hold licence interests, without following a similar pre-emptive offer procedure. This process is complicated, of course, by the large numbers of possibilities which exist for rearranging companies and their assets within groups, for reasons which have very little to do with a particular joint venture or any one licence.

It should be noted that any assignment of an interest under a licence or under a JVOA is subject to the consent of the Ministry of Energy*, and will have no effect unless application for consent is made within three months after the date of the agreement and the Minister consents to it.

PARTICIPATION BY THE CROWN

The Minister has the power, in granting petroleum prospecting licences and petroleum mining licences under the Petroleum Act, to specify the terms on which the Minister or any other person authorised who acts on behalf of the Crown is entitled to participate. Under the Ministry of Energy Act, the Minister may participate in joint ventures and other commercial arrangements.

These wide powers and discretions have been exercised in various ways over the years. At present the Minister requires that the Crown holds an 11% non-contributing interest in

*Now Ministry of Commerce

any prospecting licence with a right to participate (as a full contributor) in any mining licence.

As the Minister is, at the same time, responsible for setting policy and administering the whole regulatory regime under the Act, participants see some potential for confusion of roles. The issues have been well canvassed in other places, including no doubt the litigation over the Ngaere licence, but in the context of joint venture agreements they seem to include:

- (a) The effect of confidentiality arrangements to prevent joint venture information passing to non-operational divisions of the Ministry or (under the Official Information Act) to outside parties.
- (b) The requirement for any proposed sale of the Minister's interest to be subject to the same pre-emptive rights as any other interest.
- (c) If the Minister's interest is assigned, whether it should no longer be a carried interest but require the assignee to come in as a full participant.
- (d) The Minister's contribution must cover a share of preparing any development programme, to avoid any question that delays on the mining licence application might postpone the Minister's obligation to contribute.

ACCOUNTING PROCEDURES

Most current joint ventures include a detailed set of accounting procedures, which regulate the operator and the other participants in accounting for and reporting on operations and on assets held for the purposes of a joint venture. There is some degree of standardisation on these procedures, but some items are worth noting.

The operator, if it is conducting other businesses, must account separately for operations under the JVOA. Its record keeping should be sufficient to permit an audit of those operations by the other participants or independent auditors.

Charges levied by the operator for its own personnel and overheads must be substantiated as part of the joint account. While the other participants may not be entitled to investigate the operator's internal records, there must be some means of verifying that the charges, levied by the operator reflect the *no lose no gain* basis agreed to by the parties. One way of achieving this is for the JVOA to identify which cost components should be in the operator's charges, and for the auditor who conducts the regular independent audit of the operator's own accounts to verify that the charges do conform with the JVOA.

Another area which has led to some difficulty has been accounting for Goods and Services Tax (GST). The Inland Revenue Department (IRD) has tried several policies since GST was first introduced in October 1986. The GST Act provides for joint ventures to be registered for GST purposes, if they perform a *taxable activity*. If the joint venture was registered, all GST returns would be completed by the operator and cash calls would be simply reimbursements.

However, the IRD now considers that petroleum joint ventures do not perform a taxable activity, because any petroleum will be the property of the separate participants not the joint venture. The operator must therefore keep a record of all receipts and payments and apportion the GST content to the participants in the same ratios as the receipts and payments themselves. Thus the operator may issue a report to each participant, identifying the GST paid or received on its behalf in each month (or the participant's tax period, which may be two months). The separate participants must then file their own GST returns.

The operator will normally keep tax invoices issued to it. If the operator sells goods or services on behalf of the participants, it will need to issue a tax invoice on behalf of those participants, showing their tax numbers and the apportionment of the price.

CONCLUSION

In this paper I have touched briefly on the nature of a joint venture and referred generally to joint venture operating agreements as they are known to us in petroleum exploration in New Zealand. It will be obvious that, whatever their faults, these operating agreements, properly conceived and drafted, have the flexibility to meet the particular objectives and characteristics of many different ventures. It would be unfortunate if some of the potential legal doubts and difficulties which I have described need to be resolved by litigation. It will be even more unfortunate if litigation arises and the courts fail to recognise that these agreements reflect the needs of the industry and are made between parties who are old enough to know what they are doing, and should be interpreted to meet the intentions of the parties.

REFERENCE

AUSTRALIAN PETROLEUM EXPLORATION ASSOCIATION LIMITED (APEA) 1984: *Guidelines for an Exploration Joint Operating Agreement*.

Suggested Further Reading

AUSTRALIAN MINING AND PETROLEUM LAW ASSOCIATION LIMITED: *AMPLA YEAR BOOKS*, published annually (numerous references).

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