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**Research Paper**

# Joint Venture Agreements in the Oil and Gas Industry: Deconstructing the Limits

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***ABSTRACT***
*This paper explored the legal consequences of Joint Venture Agreements. It identified the reasons for entering into a joint venture agreement, analysed the kinds of Joint Venture Agreements enterable by Operators and drew the nexus between Joint Venture Agreements and control over Natural Resources by Host Countries. It further identified the factors to be considered prior to the termination of a Joint Venture Agreement. It concluded by agreeing that in the effort to distribute risk, maximise the use of investment capital and divide the heavy costs of construction and operation, most developing countries seeking capital often resort to joint venture arrangements as one of the most flexible arrangements available and that there is a blend of mandatory economic and political forces that bring this form of operation into ever increasing use. Whilst the considerable amount of sovereignty is restored to the government's fiscal powers, the significance of such an extension of sovereignty is that once accepted by the company, it further reduces the areas where conflict can be expected, irrespective of the unacceptably high rate of failure of the Joint venture. Similarly, successful joint ventures are considered as fostering the achievement of the major goals by each partner with clear goals within the stipulation and understanding of the objectives, interest and contributions of the joint venture partners.*
***Key words:*** *Appraisal, Joint Venture, Agreements, Failure, Operator, Oil Companies.*

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## I. Introduction

Joint Venture Agreements entered into by Operators in the oil industry are agreements between two or more parties to combine their knowledge and resources for the purpose of executing the business of oil exploration and production in the oil and gas industry. These agreements are thus entered into in order to assist in the smooth running and operational convenience of the stakeholders involved in petroleum exploration. However, the major problem upsetting joint ventures is the consideration of the possible consequences of failure. It will be understandable that a participant who had earlier decided in favour of a joint venture in preference to available alternatives will not wish to find that after a limited time, he is faced with just one or other of those alternatives, principally if that now entails total loss of control because he cannot, for whatever reason, obtain control himself.

In some circumstances, the fact that a business is operated as a joint venture may, particularly in the early stages, tend to concentrate the limelight on it and probably to show larger start-up expenses than would have been the case under the umbrella of an existing organisation where some expenditures might never have been charged to the business. Whether this is to be considered a positive or negative aspect may depend as much on the outlook of the different participants as on any strictly objective measure, but participants should take cognizance of it in judging a joint venture's results.

In many circumstances joint ventures, are not the first choice of either party. What alternatives are available depends on many factors. The principal elements in the decision must be the type of business venture in mind.In practice, it is obligatory to be aware that the enforcement of intellectual property rights and other equivalent arrangements comes up progressively more against various forms of anti-monopoly legislation and as a result is becoming less certain in its dependability. A joint venture in research and development may also come about as a convenient way for the participants to resolve a conflicting exclusive rights situation. In particular, a commentator has pointed out that teaming up with a stronger partner to improve skills or gain access to new technology or products is a risky strategy, as it usually results in the weaker partner being

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acquired by the stronger one. It has been suggested that where the participants are large corporations, it is desirable for the joint venture to have a long-term sponsor in each participating corporation.The enthusiasm and shared commercial goals which brought the joint venture participants together can equally dissipate for several reasons.

**Reasons for Entering into a Joint Venture Agreement.**

The objectives of each joint venture are basically the same. The terms and conditions vary somewhat from one agreement to another. Under this kind of arrangement, exploration plans are to be prepared and implemented, either directly by the foreign partner or through the agency of an operating company. Exploration should be to the maximum possible extent and in conformity with good oil field practice, and periodic progress reports should be submitted to the National Company. It is common place for the foreign partner to provide the capital at its own risk and is committed to spending agreed minimum amounts of money in a certain agreed number of years. If, unfortunately, after an agreed number of years, exploration does not result in a commercial discovery, the agreement automatically becomes ineffective. The multinational company, MOC will therefore not be reimbursed in any way. If, on the other hand, exploration does result in commercial discovery, the host country will have to reimburse the foreign partner for its share of the exploration expenses in accordance with a predetermined procedure.

The Agreements contain such obligations because of the potential conflict between the host country and the transnational oil company which arises from the motivation of exploring for oil. The purpose of these clauses is to make certain that the foreign oil company maximises input into exploration, not only to maximise the delay between the signing of the Agreement and the date of commercial discovery, but also to maximise the data produced for use by the host country.

Furthermore, the signature bonus paid by the multinational or international oil company when the Agreement is first signed has been common everywhere, notably in the Iranian Agreements. It has two main purposes: mainly, to increase the revenues and to speed up exploration activities. Which of the two is more important depends on whether the bonus is recoverable or not. In a situation where the bonus is non-recoverable, it provides no incentive to speed up exploration and can be regarded as a way of increasing revenue for the host country, but in the case where the bonus is recoverable from future earnings subsequently, most probably *ceteris paribus*, it clearly constitutes an incentive to the company to find commercial oil as soon as possible so that it can begin to recover its expense on the bonus.

In addition, the bonus also acts as an advance on revenue to the host country in the sense that the host country gets an interest free loan if a discovery is made, while if no commercial discovery is made the host country has at least gained some revenue in the form of the bonus. For instance, Iranian vintage agreements with Shell and the Tidewater Group, both of which failed to find commercial oil, paid to Iran $99 million, a sum equivalent to 55% of the consortium's payments to Iran in the same year. Most times, the signature bonus is intended to be a sign of the prospects for the area; nevertheless it has frequently proved an inaccurate measure. Minimum work obligations in terms of financial expenditure and or the number of rigs to be operated or the metres to be drilled are prevalent in all the agreements. Such a bonus provides the most direct encouragement to the foreign company to maximise input and minimise lag.

However, the only downside is a probable lack of flexibility if the obligations implicit are in technical rather than purely financial terms. A commentator has remarked that if the foreign company can withdraw before the end of the contract period, then a minimum work obligation becomes meaningless. Some Agreements, nevertheless, cover this by forcing the foreign company to fulfil certain obligations before opting out and to pay compensation if these obligations are not met.

Normally, in a Joint Venture Agreement, the foreign company provides the financial resources and technical expertise. In addition to marketing its own share of the oil, the Transnational Company also undertakes to market part of the entire share of the national entity, if the latter so wishes. The Joint Venture usually runs for a period of twenty five to thirty years, renewable for a further period of about half of the original duration. The effective date of the Joint Venture can either be the date of the beginning of commercial production, which tends to make the term of the agreement run separately for each field in which commercial oil has been found, or the date on which the agreement was signed or the Law of authorisation published in the official gazette, which normally makes the duration the same for all fields, regardless of the date of commencement: Egypt is a classical case. The Agreement might also make some provision for the amendment of the original contract to incorporate the improved terms that the National Oil Company might subsequently obtain under similar Agreements with other partners.

A relinquishment program regulates the Joint Venture so that after a predetermined period of time the Joint Venture will be left only with areas where commercially exploitable deposits have been discovered. While this is expected to speed up exploration, a too rapid rate of relinquishment may well defeat its own end since the company may not have sufficient time to carry out the work properly. How far this is likely to happen depends on the size of the area to be covered and the uncertainty attached to the area. One would have thought the relinquished area may have an enhanced value for the host country since it is an area in which the level of uncertainty has been reduced and the area can be re-let, except for the fact that all the evidence is very discouraging. In addition, the sharing of profit is usually a fifty-fifty formula which was already in operation under the concession regime when these joint venture agreements were first introduced. Such agreements have also provided for payment of rent and royalty. A good example is the one stipulated under the renegotiated Getty Agreement of 1968 in Algeria, where Getty undertook to reinvest 75 percent of the profits of the sale of oil.

**Kinds of Joint Venture.**

There are essentially two types of joint venture being operated in the Nigerian oil and gas industry, they are- contractual joint venture and equity joint venture.

**-Contractual Joint Venture**

A kind of joint venture broadly espoused is described as a contractual joint venture or a joint structure. The contractual joint venture is particularly common in joint ventures whose purpose is mineral exploitation. The device, even though infrequently dealt with as a distinct form of business organisation in the civil law or common law countries of the world, is nevertheless virtually always available under the general principles of contract law. The contractual joint venture, which depends almost wholly upon the mutual agreement of the parties, is highly flexible. The joint venture does not assume a separate corporate identity, as the partnership is a not constituted into a joint stock company. Instead, an operating Company which is non-profit making in nature and registered under the Local Laws of the host country, is usually formulated to act as an agent for both the foreign and national oil companies. Its capital is contributed on an equal basis. The Company is mainly responsible for production and oil produced is handed over to each of the partners in equal shares. The petroleum produced is not jointly owned; each party owns 50% of the undivided shares and consequently owns its share of production.

It is important to note here that although ownership of any petroleum discovered is joint and the operating company is jointly owned, the entire risk capital for exploration was to be furnished by the foreign partner. In the event that no commercial discovery was made, the loss was exclusively borne by the foreign partner. In the event of a commercial discovery being made, the jointly-owned operating company would be remunerated out of the revenue earned.During the exploration period, a joint venture acts as an agent only of the foreign partners while in the development and production, it acts as an agent to both parties.

Furthermore, a possible handicap of a non-profit-making company is that it may not have at its disposal any reserves and could face operational limits approved by the partners. In practice, however, the budget can be planned so as to leave enough margin of financial freedom to the management. Also, as an agent, it has powers to take any action obligatory in case of an emergency. Commentators are of the view that “The legal structure established by the 1965 agreement is not expected to hamper efficiency of management although it is not denied that in certain exceptional circumstances it could be an obstacle”. The provisions regarding joint structure agreements have been gradually strengthened over the years.” In addition, the joint structure agreement provides for a signature bonus. The financial provisions in the joint venture agreements, while proceeding on the basis of equal sharing of profits between partners as under an equity joint venture, in effect yielded a more favourable result to the government. The signature bonus paid by the foreign company when the agreement is first signed, even though not used in Egypt, has been widespread, particularly in Iranian agreements. The provisions and operation of the signature bonus has been discussed in Section 3.10 above.

Slight variations in Contractual Joint Venture agreements are common. For instance, the agreement between NIOC/PAN-AM stipulates that if a partner is unable to provide the necessary funds, such a partner could resort to raising a loan or securing the necessary funds by any other method, provided that such method must have been agreed upon by the two partners.

Date for Commencement and defining the nature of activities is usually not uniform. After the commercial discovery of oil, the operating Company normally assumes the role of agent for both the National and Foreign companies. However, there are other Agreements, where the operating companies are to be established only upon commercial discovery of oil and within 30 days thereof. This method or form of business cooperation has been preferred by the American oil companies because under the United States Tax Laws, American Companies investing abroad may obtain considerable fiscal advantages if they can prove to the tax authorities that they have direct ownership of their part of the production when such proofs are established. Such American companies are entitled to deduct certain intangible expenses from the taxable account in the year of occurrence. In addition, the Company is also allowed depletion allowance, which supposedly is a form of fiscal compensation for the depletion of deposits each year.

One can safely state that in a contractual joint venture arrangement, the National partner obtains exclusivity of title and ownership over installations and production and the foreign partner is limited to contractual rights for commercial compensation. One writer is of the view that the joint venture system of association is totally different from the traditional concession system. When the fields discovered are being developed, "the host country takes a direct part in running the joint enterprise through its own managerial, administrative and technical staff and this ensures that the country's interests are represented in all decisions affecting the winning of the oil revenue, whilst, at the same time the staff are acquiring training and experience."

Equity participation in the local subsidiaries of Transnational Corporations does not substantially mean participation in the downstream operations of marketing, processing, procurement etc. of the Transnational Corporation.It would appear that the law applicable to a contractual joint venture is generally for the parties to decide. In deciding their view, in particular, it is necessary to require the incorporation of a provision to settle disputes and to surrender to a modus operandi for resolving them. The non-existence of any preceding agreement on the applicable law can lead to adverse consequences, for instance when A and B, domiciled in two different countries, coalesce to perform a contract in country C, the laws of which may not be particularly appropriate to governing the relations between the parties and may even be hard to establish. Most times the purchasing country maintains that its law is applicable to the supply contract. The fact is that the parties may have little choice but to agree to that arrangement, even though they may well wish their own internal relations to be managed as completely as possible by some other law with which they and their advisers are more familiar. A case of two parties, one American and one English, choosing English law to govern their relations in a joint oil exploration venture in Libya is dealt with along these lines in the mentioned case. As far as can be inferred from the published material, this case is not a joint venture as defined here, since the entire management of the project appears to have resided in one party and the sharing arrangements are also at least somewhat special. Lord Brandon in the House of Lords' decision refers to it as a 'combined adventure'. The result would be that the joint venture arrangements would be governed, for instance, by Egyptian law but the supply law would be governed by the laws of the purchasing country. An additional choice is to acknowledge the local system of law, but to be in agreement to adjudicate in a third, unbiased country, e.g. Algeria.

In a situation where a corporate entity is formed, the agreement which constitutes the corporate body automatically settles the law applicable to that entity as a corporate body. The laws of some countries, e.g. France, do not recognise as valid agreements between shareholders about the conduct of a company. In choosing where to locate a corporate entity, these questions of applicable law must play a significant role, just as these and related questions, such as the language governing an agreement, have been received from the point of view of a US participant. Where a corporate joint venture is being formed to carry out activities in a particular territory, the requirement for local credibility will frequently dictate that the joint venture is corporate under the laws of the country concerned.

Furthermore, it would appear that while most legal systems allow contracting parties latitude in arranging their affairs, joint venture contracts belong to the group covered by the phrase complex long-term contracts. This, in some legal systems, particularly on the Continent of Europe, may mean that they are subject to renegotiation and probable judicial or arbitral modification in the event of an essentially changed state of affairs.

Also, in international joint ventures, it must be remarked that arbitration clauses can often be found in the joint venture contract. This, coupled with the choice of a governing legal system which would be neither party's first choice but may perhaps be in the law of the country where the arbitration is meant to take place, is occasionally considered an appropriate compromise. There is no doubt that a court or arbitrators might, in certain state of affairs, regard such a choice of law as invalid; and even more critically, it may, if upheld, lead to quite unexpected results unless the parties have totally satisfied themselves about the consequences of the legal system of their choice on any interpretation of their contract. In particular, in some jurisdictions, arbitrators have the right to adjust a contract to what they see as apposite in the situation.

It has been recommended that in international joint ventures relating to numerous parties there is a good case for multi-party arbitration. This would appear to have validity where all parties request a declaration of the same problem, and has the addition advantage of reduction in time and costs. However, it must be borne in mind that notwithstanding any provision for multi-party international joint venture arbitration, scores of disagreements may possibly not be of such a nature as to be amenable to arbitration in that type of forum.

There is a growing recognition that the progression from a traditional concession regime to a joint venture does not significantly affect the location of control of the decision making process, so long as a Transnational Corporation continues to manage the undertaking. In short, the mere acquisition of a majority equity interest does not disentangle the extractive industries of developing countries from the global network of Western Transnational Corporations or the occurrence of the old international economic order. Unless transfer of ownership is matched by a meaningful transfer of essential managerial powers and the acquisition and mobilisation of technical expertise for the purposes of effective management, the control of this sector by a developing country will prove largely illusory.

**-Equity Joint Venture**

Equity Joint Venture (Under the Italian approach) is usually characterised by closer partnership ties. The joint venture is a separate entity in the form of a joint stock company created under the local laws of the host country to conduct, as a corporate body, all phases of the operations, as well as the marketing of oil. These types of joint venture encompass arrangements where direct and significant participation in the investment is made by the two parties to the company. Know-how, technical assistance or personnel are made available under the contract between the operating company and the foreign partner. The operating company is run as an independent corporation, with profits distributed to the parties to the joint venture in the form of dividends. The parties exercise control of capital stock. Policy and other major decisions are made by the organs of the operating company. Autonomously, in theory, of the holding companies, in the equity type of joint venture, the ratio of participation varies between a foreign minority, a foreign majority and a 50-50 arrangement. In no case is the mutual control by the parties affected. When the local partner has a minority of interest, it may still enjoy a right of veto. When the foreign partner is in the minority, the local party's need for technical assistance and know-how may result in giving the foreign partner being given a degree of control superior to its voting power.

Further, it can be remarked that the earliest joint ventures were those established by ENI and certain Egyptian concerns and by Agip Meraria, an ENI subsidiary, NIOC of Iran, both in 1957. In this case, each partner owned 50 percent of the equity. The company was in charge of the functions of exploration and sale of any crude oil or other hydrocarbon that was produced. It has been argued that "The symbolism of the joint venture lies not simply in its jointness and in the existence of an entity called a State Oil Company, but also in the fact that the territory is not licensed solely to a foreign oil company." Agip could retain only those areas in which commercial quantities of oil were discovered. A commercial quantity embodied in the ENI-Agip agreement was as follows:

*'The yield capacity of a petroleum field in commercial quantities in which a commercial quantity will, under prevailing conditions, be estimated when the amount of oil extraction reasonably foreseeable is such that when the cost price of delivery seaboard, calculated on the basis of production costs plus transport and handling charges and an additional 12.5% of the posted price payable as a minimum for tax and duties to the Iranian government is deducted for the posted prices of a similar kind of petroleum, it would leave a reasonable margin of profit'.*

It is important to note that this Agreement, however, did not incorporate a mechanism which would enable one party to proceed to development at sole risk, in the event that there was difference between the parties on the assessment of the commercial prospects of a discovery. Such a problem however arose under the Agip – NIOC agreement. To correct such anomalies, a formal mechanism was incorporated in the Agip – NIOC agreement to deal with the deadlock. This mechanism was not satisfactory, even though it provided a formal procedure for resolving a deadlock; it was more akin to an adjudicatory procedure than one for arriving at a consensus in the interests of the joint venture.

Furthermore, with time, a more resourceful mechanism was developed and incorporated in later joint venture agreements to deal with situations where the parties did not agree on the commercial prospects of a discovery. A clause was inserted which enabled either party to undertake discovery at its sole risk". For this reason, the risk clause was incorporated in the Pan American – UAR Agreement of 1963, under which the operations were entrusted to the joint operating company, the Fayoum-Petroleum Company (Fapco).

The sole risk clause was invoked in the Abu Qir gas discovery in Egypt by Phillip in 1969, which the company did not regard as commercial but which the government decided to develop at its "sole risk" in order to meet domestic requirements. To some extent the sole risk clause may make the definition of a commercial discovery redundant. The sole risk clause allows either partner to develop a field at its own risk subject to certain conditions and provisions. This clause allows either side to opt out of the development of the find. Nevertheless, the sole risk clause usually only becomes operative once the venture has been created, i.e. a commercial discovery has been formally declared which still leaves open the problem of defining the first discovery as commercial or otherwise. What the sole risk provision actually does is to make the precision of the definition less important, given that once the venture exists, neither party is obliged to commit itself to the development of the field as the result of a declaration of commercial discovery.

In addition, the "sole risk" clause has been praised as one of the commendable instances of elasticity made possible by the joint venture structure. The sole risk clause was introduced to provide a remedy for partnership problems where using arbitration clauses of the agreement was regarded by both sides as tantamount to a divorce. In a situation where the sole risk operation has been wholly financed by the opposing party in case of a failure then the loss is borne by the opposing party only. But, on the other hand, if the sole risk operation is a success then after a certain time the opposing party has the right to join in the operation but must pay a penal rate to do so. Moreover, another case of flexibility is provided by the mechanism, embodied in the Pan American-UAR Agreement of 1963, to deal with a situation where a project is approved by both parties but one party is either unable or unwilling to share in financing it.

In terms of the production phase, an obligation was imposed on the joint company to use all its possible efforts in order to raise to a maximum the sales level of production and for that purpose to develop the production of such fields so that production was achieved within the limits compatible with the most modern technical procedures in the oil industry.One conspicuous problem presented by the joint venture is the relationship between production and “offtake” by the respective parties. So long as both parties lift oil in proportion to their equity interest, the arrangement presents no difficulty. However, as a writer has observed, a “problem arises when there is a persistent under-lifter. The obvious solution would be for the over-lifter to provide the necessary additional capital, but this would create the problem of altering the equity share of the two sides.

Therefore, the over lifter must be able to buy crude from the persistent under lifter at a specific price. Intended for both parties to invest in the necessary capacity in such a way as to leave the equity interest unchanged, the under-lifter must receive a price for the crude oil which will provide a return on capital equal to or greater than a return from any alternative form of investment. The joint venture therefore had to provide a mechanism to deal with a situation where one party is likely to persistently demand less crude in proportion to its equity than the other. This is the period between early 1960 and late 1970 which was a period of falling oil prices and the crude oil market was generally slack. During this period, it was the national oil companies of the host country who were sellers of crude oil and not to the processors as the latter had difficulties in disposing of their offtake. The Iranian situation, where NIOC was anticipated as the under-lifter is a classic example.Secondly, the price demanded by the under-lifter as compensation should not be so high as to have an effect on the level of demand of the offtake.

This situation is convoluted by the fact that, in a joint venture state of affairs, the foreign company and the host country require the crude for different purposes. The transnational oil company has entered the venture to secure the supply of owned crude.Most transnational oil companies entering joint ventures till date, have been crude deficit companies in the sense that their refinery capacities exceed their supplies of owned crude oil. This in essence means that the foreign company needs the crude as a refinery contribution. The host country’s national company, on the other hand, will demand the crude as a revenue earner in a direct sense. The fundamental distinction is that the foreign company as an integrated operation is not unswervingly interested in maximising revenue at the production level of the operation, particularly with regards to one source of crude from perhaps many accessible to the company. The host country nonetheless, is interested in maximising revenue at this stage as a seller of crude. This problem is dealt with by different mechanisms embodied in the provisions relating to marketing under the Agip-NIOC agreement.

**The Nexus Between Joint Venture Agreements and Control Over Natural Resources By Host Countries**

For some time now, most developing countries have sought to establish control over the activities of transnational corporations by obtaining a majority interest in the equity or assets of their local subsidiaries. The general experience of most host government is that the corporate structure of transnational corporations consistently denies the subsidiaries that measure of self-sufficiency that would permit them to be wholly incorporated into the economic strategies of the host country. For that reason, the attainment of control over subsidiaries is regarded as a compelling device for dismantling the restrictions imposed by the parent company. In following this device, some developing countries appear to have advanced on the premise that the acquisition of ownership necessarily implies effective control, but the experience of many developing countries, predominantly in Africa, belies this proposition. This was the reasoning of the court in the case of *Anaconda Company v Overseas Private Investment Corporation* and the tribunal came to the conclusion that “control, as applied to corporate operations, is an elusive term dealing, as it sometimes does, with the degree of influence in fact or potentially exerted by some persons within a complex structure over a multitude of actions taken by many others. In differing legal contexts, different aspects of that influence can assume greater or lesser importance; sometimes actually exercised present control is more important than potential but dormant control and sometimes the reverse is true”.

**-Three phases in quest for control over natural resources**

Furthermore, it has been observed that with time, emergent nations coming to grips with the problem of independence often go through three distinct phases in their quest for control over their natural resources. Each phase has a distinct political significance, though it may exert little or no impact on the existing structures for controlling the development and exploitation of the particular natural resource.

**-Political sovereignty**

The achievement of political sovereignty is the first phase. Nationalists inveighing against a colonial regime have always looked upon political independence as tantamount to economic independence and unregulated control over their natural resources. However, after the first flush of excitement over this phrase, emergent nations soon came to realise that control over their natural resources is still a distant goal.

**-Vesting Mineral Resources in the State**

The next phrase consists in the resounding assertion through legislation that all mineral resources are vested in the state. It soon becomes apparent that actual control does not fundamentally begin from such a declaration. It would appear that effective control of the undertaking in economic or practical terms may still elude the host government even after taking this step, however politically appealing it may at first appear.

**-Control within the Transnational Investment Process**

In the transnational investment process, control involves the exercise of decision making powers in such vital operational and managerial matters as budget, expansion and development programs, appointment of top management, pricing, marketing, declaration of dividends, borrowing, reorganisation, procurement of equipment, and the integration of the undertaking with the developmental objectives of the host countries. Thus, the proper test of the suitability of any new arrangement purporting to vest control in the host government will include consideration of the following factors:

(1) Does the acquisition of a majority equity position confer upon the host government the right to recommend a majority of the members of the governing board or committee? Some host governments have been content to appoint only half of the members of the board or committee, notwithstanding their majority equity position. Such an arrangement without a doubt rules out a controlling position for the government at the board level. In consequence, a concession to the suggestion much explored by transnational corporations that a genuine joint venture means a 50:50 equity partnership in which neither party has a controlling interest is an explicit acknowledgement of the principle that majority ownership and control are two separate concepts.

(2) Does the host government really wish to have control? A good example is Ghana, which terminated its management agreement with all foreign-owned timber companies in which it acquired a majority equity interest. A perceptive observer has succinctly recapitulated the financial repercussions of the joint venture as follows: "A Joint Venture Company is consistent with the national aspirations of developing countries but their Governments recognise that taking shares in the company is not going to change the 'bottom line' figure to an investor. Whether a mining company pays a Government in the form of dividends, royalties, profits taxes, bonuses or surface rentals, such payments must come out of the 'bottom line'. The return to the investor is discounted cash flow."

(3) Is the arrangement the status quo in new clothing? The International Corporations themselves have overcome their reservations about joint ventures with host Governments in the extractive sector. They have also realised that such ventures may effectively resolve nationalist objections to foreign control of natural resources without significantly thinning the Corporation's actual control or its financial gains or returns. Furthermore, from the operational viewpoint, The Government's equity interests coupled with the presence of important Government officials on the board of the Joint Venture assures easy access to local capital and other facilities such as import licenses and permits from the Government agencies and then, by so doing, improves communication between the host country and the foreign company. Newly instituted indigenisation schemes, now very much in vogue in Nigeria, Ghana and many other developing countries, have, as their sole object to enable Nationals to assume command of the economy. But it needs to be appreciated that the transfer of a majority equity interest in foreign owned enterprises to the citizens of the host country does not necessarily guarantee a change of control. Problems posed by ownership and control have attracted the attention of the intergovernmental working group of the United Nations Commission on Conduct for Transnational Corporations.

**Economic Advantages of Joint Ventures**

We now go on to question whether joint venture is mutually beneficial to the parties concerned and, in areas where there are lacunae, look at ways of dealing with such drawbacks. There is a growing recognition amongst commentators that financial benefits and costs of joint ventures may be consistently coordinated. From the host government's point of view, the financial and economic benefits depend to a large extent on the structure of the fiscal regime, the compensation formula for the equity interest acquired by the government, and the economic connection provided for in the arrangements. The financial returns to the host government may be significantly increased if it retains the right to impose a royalty in addition to such other forms of return as taxes on the income of the venture and on the shareholders' dividends, surface rental, bonus payments, and mineral duty, not to mention the dividends which may accrue to its newly acquired equity.

Furthermore, the joint venture agreement differs in a number of significant respects from the rentier arrangements. Initially, the host country obtains a direct share in the real profit of the operation as opposed to a merely fiscal benefit. Whereas in the traditional concession the host country received 50% of the profit in tax, the profit was a notional accounting figure. In the early sixties, the income tax transformed into an almost pure per barrel tax, whereas in joint venture circumstances, the host country, through its national oil company, earns a proportion of the real profits of the operation.

The financial benefits are less apparent where the governments obtain an equity interest in lieu of all royalties, income tax, and other obligation, as in the Lamco Project in Liberia. Where such arrangements pertain, the amount of foreign capital and expertise brought in tends to be lower, and requirements for domestic capital and expertise are consequently higher in the case of a joint venture than in a completely foreign-owned subsidiary. The joint venture approach consequently implies a lower aggregate level of investment for the company as a whole than would otherwise be possible. Furthermore, the fact that profits have to be shared with the local equity holders creates a motivation for the parent company to reduce locally declared profits by making use of whatsoever flexibility exists in the pricing of inputs and outputs, by charging the full costs of technical, managerial, and other services supplied from headquarters or affiliates, and by other means.

Some commentators are of the view that aside from the capital shortage, the primary pull towards joint venture appears to have come from the growing nationalism in the less developed countries. Enterprises in developing countries have tended to demonstrate a considerable reluctance to engage in joint venture. This reluctance has finally broken down as it has been revealed either that this is the only form of foreign investment available or that it at least contains advantages over wholly owned investments for relations within the less developed countries. A joint venture company is consistent with the national aspirations of developing countries but their governments recognise that taking shares in a company is not going to change the “bottom line” figure to an investor. Whether a mining company pays a government in the form of dividends, royalties, profit taxes, bonuses, or surface rentals, such payments must come out of the “bottom line” – return to the investor, its inexpensive cash flow.

Also, it is therefore not surprising that international corporations themselves have overcome their earlier reservations about joint ventures with host governments in the extractive sector. They have become conscious that such ventures may efficiently silence nationalists’ objections to foreign control of natural resources without considerably reducing the corporation’s *de facto* control or its financial returns.

Furthermore, from the operational point of view, the government’s equity interest, coupled with the presence of important government officials on the board of the joint venture, assures easy access to local capital and other facilities such as import licences and permits from governmental agencies and generally improves communications between the government and the transnational corporations. The withholding of control by a transnational corporation with a minority equity interest, nevertheless, is still more pronounced within the framework of joint ventures with nationals of the host country or a group of entities in that country. The management of a company may exercise effective control without owning any share capital. Where the transnational corporation holds an equity interest, albeit a minority interest in the joint venture with nationals, its ability to retain control is enhanced not only by all the factors recounted above, but also because the local shareholders are usually dispersed and therefore unable to mobilise the strength needed to exert meaningful control or influence over the operations of the undertaking.

It should be noted that quite independently from probable financial and economic benefits, joint ventures, when appropriately handled or supervised, could serve as functional mechanisms for management and technical training. They could also provide access to the operational strategies, policies and techniques of a transnational corporation. To point out the possible drawbacks in such arrangements may effectively undermine the development strategies of host governments.

On the part of capital exporting countries, the range of motives expressed by transnational companies is broad. At one extreme, there is a strong opposition in principle to joint ventures; at the other there is an acceptance of joint venture as the most appropriate and rewarding way of doing business abroad. Between these two extremes, there are at least two intermediate positions: one prefers solo operations but accepts joint ventures as occasionally unavoidable; the other is neutral, accepting without any preferences either the joint venture or solo venture, depending on the dictates of opportunity, circumstance and direct advantage. The trend is toward increased acceptability of joint venture. It would appear that company policy, in earlier times unbendingly set in favour of solo ventures, has now yielded to a pliable policy of acceptance of joint venture.

The host country can raise its sovereign rights to impose an external regime of laws, regulations, and administrative practices which may significantly achieve the control that has eluded its representatives in the boardroom. The effectiveness of an external mechanism of control, of course, will depend on the nature of the control sought after, the sector in which the transnational corporation is operating, the nature of the enterprise, and the effectiveness with which the relevant laws are enforced.

There is however a need to further explore the primary causes of termination of a Joint Venture Scheme, as well as listing the top ten issues to bear in mind when considering whether to terminate a joint venture or not and they include:

**Termination for cause**

It is possible that a joint venture will terminate as a result of an event of default. A well-crafted joint venture agreement ("JVA") will specify the obligations of the joint venture parties and will clearly and accurately express those circumstances or events which constitute an 'event of default'. Commonly encountered event of default scenarios include: (i) insolvency of one party (or possibly its parent company), (ii) material or persistent breach of the JVA, (iii) change of control of a joint venture party (particularly if the party acquiring control is a competitor of the other joint venture party), or, (iv) an attempted transfer of a party's interest in the joint venture other than in accordance with the JVA.

If an event of default occurs and the JVA does not contain any specific contractual remedies, then the innocent party may terminate and seek damages. Given the difficulty in quantifying the 'loss' suffered, the JVA may contain a default 'put and call' mechanism, which allows the innocent party either: (a) to acquire the shares of the defaulting party at a discount to fair value (although care should be taken to ensure that the discount is not so great as to constitute a 'penalty' and, as a result, unenforceable) or (b) to sell its shares to the defaulting party at a premium to fair value (the premium acting as a deterrent to a party looking to engineer a default with a view to being bought out).

**Fixed term or specific objective**

Some joint ventures are established for a fixed term or for a specific objective. Once the term has expired, or the objective has been achieved, the joint venture automatically terminates, with the joint venture wound up and any assets distributed between the joint venture parties.

**Termination as a result of an exit event**

Joint ventures may come to an end simply through the sale of one or all parties' interests in the joint venture (as was the case in the TNK-BP joint venture).

**Termination due to deadlock**

It is possible that, as a result of a deadlock, parties may be unwilling or unable to continue with the joint venture, resulting in an exit being sought. Our second article in this series contains more detail on this subject and highlights the various mechanisms available to deal with such a situation.

**Key considerations when terminating a joint venture**

We are often asked to advise on the key issues to consider when a party is contemplating bringing a joint venture to an end. In most instances, the business of the joint venture will continue and one party will simply acquire the joint venture completely and go it alone, on the basis that the interests of neither party are likely to be served if the business is broken up and the assets liquidated or a sale forced upon the parties. It is therefore from this angle that we have compiled the following list of top ten considerations. The key factors will, of course, vary depending on the structure of the joint venture. In the oil and gas sector, for example, contractual joint ventures are commonplace and so the considerations will therefore differ from those set out below.

**1. Change of control**

The joint venture company is likely to have entered into a number of commercial contracts with suppliers or customers. These contracts may provide that they can be renegotiated or terminated if there is a change in control or ownership of the joint venture company. These contracts should be identified prior to terminating the joint venture and appropriate consents obtained. Indeed, when negotiating such contacts, the definition of 'change of control' should exclude the situation where one of the joint venture participants simply acquires outright control.

**2. Risk profile**

A joint venture is a popular vehicle for commercial activity in the Energy & Natural Resources sector due to the inherent uncertainty and risk associated with many types of energy projects. The number of variables, as well as the often significant capital requirements, particularly in offshore projects, means that it is often preferable for risk to be spread among one or more parties.

When termination of a joint venture occurs in circumstances where one party continues the business of the joint venture, then they do so with increased risk and will ultimately bear the sole risk of failure. A full and thorough risk assessment of the joint venture business should be carried out and measures taken to de-risk the venture to a suitable level, which may entail seeking a new partner.

**3. Experience**

In addition to the spreading of risk, experience will be a key determinant in selecting a joint venture partner at the outset. A party seeking to terminate a joint venture by buying out its joint venture partner will need to assess whether it alone has the requisite knowledge and experience to achieve the objectives of the joint venture. This will be material where there is a shortage of expertise in the particular field such as joint ventures involved in unconventional gas.

**4. Financial considerations**
If, as part of the termination, one party will acquire the other party's interest then the acquirer should ensure that appropriate funding is in place for the initial purchase, which may require entering into capital/debt markets or even securing a new partner. It is also important to understand any existing finance provided to the joint venture by the exiting party, since this will undoubtedly require to be dealt with as part of the exit. If the exiting party requires its loans to the joint venture to be repaid, the remaining party should carefully consider its ability to refinance that debt.
**5. On-going funding**
It is also of critical importance that the on-going CAPEX and OPEX requirements of the joint venture business are understood to ensure termination does not result in a funding gap. The outgoing partner may also have granted a parent company guarantee in respect of the joint venture business, which may need to be replaced.
**6. Assets**
The joint venture may use assets, such as intellectual property or IT, which are owned by the exiting party. Consideration should be given as to how the joint venture business will operate without these assets or whether viable alternatives exist. If no reasonable alternatives exist then, as part of the exit, contracts will have to be put in place with the exiting party to ensure continued use (e.g. transitional arrangements, whether long term or for an appropriate run off period). Naturally these arrangements will come at a cost, which should be factored into the exit negotiations.
**7. Goodwill protection**
A well-drafted JVA will include controls on the use of confidential information shared for the purposes of the joint venture, as well as restrictive covenants which seek to protect the goodwill of the joint venture business. These provisions are likely to continue beyond termination of the joint venture, so the parties must fully appreciate what they can and cannot do following termination. An existing party will not want to discover that its core business is in fact caught by the non-compete restrictions within the JVA.
**8. Staff**
Responsibility for staff employed by the joint venture, either permanent or on secondment, can be problematic. Seconded staff are likely to return to their original employer, which may leave the joint venture under resourced. Alternatively, if the joint venture parties do not intend to integrate staff back into the parent businesses, the costs and related effects of redundancies will need to be considered.
**9. Pensions**
Any pension arrangements which have been put in place for the joint venture staff will merit consideration. Required actions will depend on whether the staff will transfer to another employer or be made redundant and also on the nature of the arrangements in place. The joint venture may have set up its own pension arrangements or used those of a joint venture party. The nature of the benefits provided by the arrangement will be relevant. A defined benefit arrangement with a funding deficit could have significant cost implications.
**10. Tax implications**
Tax implications will be a major consideration in deciding which method of termination is most appropriate for a specific joint venture. This article is based on the assumption that the joint venture is a limited liability company. In this case, the transfer of assets back to the joint venture parties on the winding up of the vehicle may give rise to a corporation tax charge (as well as stamp duty and VAT depending on the type of asset). The sale of shares in the joint venture by a joint venture partner may qualify for Substantial Shareholding Exemption, but would otherwise result in a corporation tax charge. It is also possible for a joint venture to be established as a partnership in which case the transfer of assets back to the partners can give rise to capital gains tax charges. Other taxes can apply depending on the assets and circumstances involved.
As is evident from the above, the effect of a termination event on the business of a joint venture can be far reaching. Joint venture parties should consider the wide range of commercial, operational, legal and practical issues which could arise as a result of terminating a joint venture. Indeed, joint venture parties would be well advised to carry out thorough due diligence in advance of any termination to ensure, where the intention is to continue the business, that: (i) the joint venture is sustainable; (ii) the value of the joint venture business will not be materially eroded, and (iii) there are no unwanted surprises following termination.

## II. Conclusion

In an effort to distribute risk, maximise the use of investment capital and divide the heavy costs of construction and operation, this paper has identified that most developing countries seeking capital now resort to joint venture. The joint venture is beyond doubt one of the most flexible arrangements available. The idea may not be new, but in today's business climate, there is a blend ofmandatory economic and political forces that bring this form of operation into ever increasing use. A considerable amount of sovereignty is restored to the government's fiscal powers. The significance of such an extension of sovereignty is that once accepted by the company, it further reduces the areas where conflict can be expected. Nevertheless, the failure rate is unacceptably high.

Successful joint ventures are considered as fostering the achievement of the major goals by each partner. These goals are a clear stipulation and understanding of the objectives, interest and contributions of the joint venture partners and it is recognised that joint ventures are most likely to succeed when each partner has clear cut objectives and it's cognisant of the objectives and the interest of the other partner.

Finally, the essence of a joint venture is the successful acquisition of foreign technology leading to rapid technological assimilation and adaptation which is a valid and requisite*sine qua non* for industrial development, economic progress, and technological self-reliance.

Although the terms of joint venture agreements were initially more favourable to host countries compared with the traditional concession regime, they have not remained static. Due to the changed circumstances and the improved bargaining power of some of the host countries, particularly OPEC producer countries, many countries have been able to negotiate new and better terms of agreement. Joint venture expresses the idea of partnership well, and it is only on the basis of partnership, that the economic progress of the less developed countries can be achieved and that it will be possible to impart the experience and resources of the more developed countries to nations that want to bridge the gap without sacrificing national pride and human dignity or compromising environmental standards on one hand and that irrespective of the susceptibility and grave consequences of the failure of Joint Venture Agreements, it still remained a most formidable, effective and form of operational and transactional Agreement for the operators in the industry.

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