www.standard-club.com

Offshore Bulletin

November 2016

The Standard
for service and security

The Standard

John Croucher
Head of Division
+44 20 3320 8879
john.croucher@ctplc.com

In this edition

Welcome to the 11th offshore special edition of the Standard Bulletin.

The past 12 months have continued to be extremely challenging for the entire market and increasingly the phrase 'lower for longer' is being accepted as the prevailing wisdom. Despite this, there have been a few positive developments that may cause some commentators to revise this view. Following the meeting of the Organisation of Petroleum Exporting Countries (OPEC) in Algiers in September, a decision was made to cut production and end Saudi Arabia's 'pump at will' policy. Whilst many will welcome a reduction in supply, it remains to be seen whether other independent oil-rich nations will follow suit, as this will determine how long the current oil stocks will continue to suppress oil prices and whether currently on hold projects will remain unviable.

Rather than spend too much time trying to stare into the oil price crystal ball, this special edition focuses on some of the recent legal and contractual reforms, and also looks at a trend of technological innovation and operational diversification as shipowners seek new ways to maximise opportunity in a difficult environment.

Firstly, we look at the latest positions of the BIMCO Supplytime revision and development of an Offshore Dismantling Services contract. Ursula O'Donnell and Sarah Wallace sit on the drafting committees for these contracts so are ideally placed to provide an update on their progress.

We then ask some questions about establishing causation. Nigel Chapman and Sophie Shiffman from Clyde & Co demonstrate that causation is not quite as simple as asking 'what actually happened?', but is often determined by what happened where, as jurisdiction is key.

We continue looking at international law and how different countries might be able to further improve their approach to regulation as Godofredo Mendes Vianna from Kincaid updates us on the Brazilian Maritime Law reform and Nicholas Mavrias looks at safety and environmental management in Australia.

Andrew Lee from Hill Dickinson takes us through incorporation by schedule and the problems created by conflicting provisions, orders of precedence and the courts' approach to interpretation in these situations.

Finally, Joseph Divis and Sian Dinnadge look at recent technological innovation, emerging risks and how the club approaches supporting its members as they continue to adapt and develop their capabilities, as they have done since the first offshore operations in the 1970s.

Thank you to all of the authors for their contributions.

Some limitations of BIMCO's Supplytime 2005 contract

Ursula O'Donnell
Claims Director
+44 20 3320 8813
ursula.odonnell@ctplc.com

Some limitations of BIMCO's Supplytime 2005 contract.

Bimco's Supplytime 2005 contract (Supplytime 2005) is one of the most frequently used time charterparties in the offshore sector. It was originally produced in 1975 and subsequently revised in 1989 and again in 2005, and is currently undergoing a further revision[1]. The contract was originally designed for chartering tugs and offshore supply vessels to support drilling rigs or mobile production units involved in offshore oil/gas exploration or production. However, it is sometimes used for other purposes, eg to support contractors engaged in offshore construction or decommissioning. We have found through The Standard Club's offshore contract review service that there are some limitations to the standard wording of the contract if it is being used by members who charter their vessels to assist in these types of operations.

Scope of indemnities

The allocation of liability in Supplytime 2005 is on 'knock-for-knock' terms, whereby the owners and charterers each assume liability for damage to their own and their contractors'/subcontractors' property, and for injury to their own and their contractors'/subcontractors' personnel, regardless of which party is negligent, which is supported by reciprocal indemnities (clause 14(b)). In addition to this, the charterers assume liability for the property and personnel of their co-venturers and clients (referred to as customers in the contract) who have a direct contractual relationship with them, in respect of the job or project on which the vessel is employed. This benefits owners because charterers often hire the vessel as part of a wider project where they are not the owner of the offshore unit (ie the drilling rig, production unit or offshore installation etc) to which the chartered-in vessel is providing services.

Although charterers assume liability under the knock-for-knock in the contract in respect of entities down the contractual chain, this does not extend to all entities up the contractual chain, ie it does not include the co-venturers or other contractors/subcontractors of the charterer's client. It also does not include other clients up the chain (including their respective co-venturers and contractors/subcontractors), which may include the ultimate client of the project (ie if the charterer is acting as a subcontractor of the project's main contractor).

1 Ursula O'Donnell is a member of BIMCO's specialist subcommittee, which is currently revising the Supplytime 2005 contract.

Owners will not be protected under the contract from being exposed to potential claims in tort (for personal injury or property damage) from these other entities, as they fall outside the scope of the knock-for-knock allocation of liability. For example, the charterer is installing a platform on behalf of its oil company client and charters a vessel on unamended Supplytime 2005 terms to assist in carrying out the installation work. Whilst navigating, the vessel negligently causes damage to property owned by one of the client's other contractors. The owners will face a potential claim from them in tort, and will be unable to seek an indemnity from the charterers under the contract because this liability falls outside the scope of the knock-for-knock regime.

It is common for Mutual Hold Harmless Indemnity Arrangements (MHHIA) to be in place between the various contractors (and subcontractors) working on an offshore construction or decommissioning project, whereby they each assume liability for their own property and personnel on knock-for-knock terms. However, the contractors may not all sign up to these arrangements or it may not be possible for the owners to determine who has signed up to them. In the above example, if a claim is pursued against the owner, it may be able to rely upon the right to limit its liability (under The Convention on Limitation of Liability for Maritime Claims 1976 (LLMC) as amended by the 1996 Protocol), which is based on the vessel's gross tonnage, but this will only apply if the project is being carried out in a jurisdiction where the right to limit applies under applicable law.

Members should therefore consider when negotiating the contract (in the absence of an appropriate MHHIA being in place) whether the definition of the Charterers Group in Supplytime 2005 is appropriate in the context of the project or whether they need to negotiate an amendment so that it is broadened to include other named entities or levels of contracting party with whom the charterers shall be engaged.

Consequential losses

Another limitation of Supplytime 2005 is the wording of the exclusion for consequential losses (clause 14(c)). Although consequential loss is defined in the contract to include 'loss of use, loss of profits, shut-in or loss of production', as a matter of English law, this only excludes indirect losses, which means that owners face a potential exposure in respect of direct losses.

This is because the term 'consequential loss' has been given a very specific meaning under English law. Direct losses means losses that arise naturally from a breach of contract, whereas consequential losses refers to losses that are not ordinarily foreseeable and are only recoverable if special circumstances are known to the parties when they contracted[2]. For example, if a vessel chartered under Supplytime 2005 damages the charterer's group property as defined under the contract, eg the vessel's anchor drags a pipeline owned by the charterer's client, the owner shall be protected against claims for physical damage to the pipeline under the knock-for-knock regime (under clause 14(b)). However, the owner shall not be protected from consequential losses that flow naturally from the damage, which includes loss of production/loss of profit (under clause 14(c)), as these are construed to be direct losses under English law[3].

2 Hadley v Baxendale (1854) 9 Ex 341
3 Deepak Fertilisers and Petrochemical Corp v ICI Chemicals & Polymers Ltd [1999] 1 Lloyd's Rep 387

Some limitations of BIMCO's Supplytime 2005 contract continued

Members should consider whether they need to negotiate amendments to the standard wording of the consequential loss clause in Supplytime 2005 to ensure that it excludes all relevant categories of direct and indirect losses in the context of the particular project for which the vessel is being used.

Under English law, very clear language must be used in exclusion clauses. This has been highlighted by the recent case of *Transocean Drilling UK Limited v Providence Resources plc*[4], which dealt with the meaning of 'loss of use' in the context of an exclusion clause for consequential loss in a drilling contract. The court held that Providence (the field operator) was not prevented from claiming damages for its spread costs against Transocean (the rig owner), ie the cost of obtaining personnel, equipment and services from third-party contractors, which were wasted as a result of Transocean's failure to maintain the rig, which led to delays. The court decided that, in this context, 'loss of use' meant the loss of expected profit derived from the use of the rig and did not encompass wasted spread costs, as the other contractors providing the 'spread' were still available. Transocean appealed against the decision and the Court of Appeal found in its favour, by deciding that the spread costs fell within the exclusion for loss of use in the consequential loss clause.

Conclusion

The above limitations in the wording of Supplytime 2005 are currently being reviewed by the BIMCO subcommittee tasked with revising the form. In the meantime, members should consider when they contract on these terms whether they are sufficiently protected under the standard knock-for-knock allocation of liability in the contract. This will depend upon the scope of work, ie whether the vessel is engaged to carry out straightforward supply/support services or assisting construction/decommissioning operations, and if the latter, where the charterers sit in the contracting chain. If the charterers are not the main contractor for the project and/or there are insufficient MHHIAs in place in respect of the other contractors/subcontractors at the worksite, members should be aware that this may expose them to potentially onerous liabilities.

4 Transocean Drilling UK Limited v Providence Resources plc [2014] EWHC 4260 (Comm.) Arctic III and [2016] EWCA Civ 372

BIMCO Offshore Dismantling Services Agreement

Sarah Wallace
Senior Claims Executive
+44 20 3320 8900
sarah.wallace@ctplc.com

With the expected increase in decommissioning projects, the time is right to create a standard decommissioning contract which can help to reduce the costly and time-consuming process of negotiation for the parties involved.

Decommissioning is on the rise

Over the coming years, a growing number of offshore oil and gas facilities and installations are to be taken out of service, and there is expected to be a huge increase in decommissioning projects as the oil and gas infrastructure matures and facilities offshore become obsolete or uneconomical to sustain. The opportunities for decommissioning in Asia, the North Sea and the Gulf of Mexico are significant.

A complicated contract

Most offshore facilities are tailor-made, so the ability to reuse the facilities is often limited. This is good news for the decommissioning industry, but also means that contracts for decommissioning works are usually extremely complicated, as drafters wish to include a wealth of information as well as attempt to address every eventuality that may arise.

We have seen a number of bespoke decommissioning contracts through The Standard Club's contract review service. These heavily amended contracts are generally costly and time-consuming to negotiate, so it was felt by a number of people in the industry that it would be in the interest of all parties if a standard contract was available for use worldwide.

The BIMCO decommissioning contract

The development of a decommissioning contract has been on BIMCO's work programme for some time. BIMCO has now initiated a new project to develop a marine services agreement for dismantling oil and gas production facilities and infrastructure. The drafting team includes representatives from Maersk Supply, Bibby Offshore, the International Marine Contractors Association, the International Salvage Union, the UK Chamber of Shipping, The Standard Club, Holman Fenwick Willan and BIMCO.

The subcommittee first met on 5 April 2016. It was agreed that the new contract would be based on BIMCO's WRECKSTAGE 2010. The intention is for the work scope, equipment and personnel needed to be agreed between the parties and annexed to the contract. The contract itself will set out the obligations and liabilities of each party. Drafting is progressing and it is hoped that the new contract will be presented to the BIMCO Documentary Committee for adoption in 2017. In the meantime, members are encouraged to contract on knock-for-knock terms and engage with the club in relation to any decommissioning projects.

What caused the problem? It depends on which law you chose...

Nigel Chapman, Partner
Clyde & Co
+44 20 7876 4501
nigel.chapman@clydeco.com

Sophie Shiffman, Associate
Clyde & Co
+44 20 7876 4225
sophie.shiffman@clydeco.com

An enquiry into causation is usually a 'real world' enquiry into what actually happened, with experts producing root cause analyses and lessons learned. The necessity and value of such enquiries is well understood by the club's membership, both to understand why problems have occurred and, crucially, to prevent their reoccurrence.

At first sight, this looks like a typical lawyer's answer to what ought to be a relatively straightforward factual enquiry. However, the law has an important role to play in such enquiries, because causation has an important legal context and that legal context varies dramatically by legal system and by decision-maker. In this article, we will compare the different approaches taken in different jurisdictions.

English law

The starting point of enquiring into causation under English law is to identify all possible causes by asking whether the loss would have occurred 'but for' the cause under consideration. It does so by applying the court's 'common sense' (that lawyers and common sense might mix can come as a surprise to many). Whilst this is a broad test, it is not so broad as to catch everything that leads chronologically to the loss: a drilling contract between a rig owner and an operator is not a cause of personal injury to a roughneck whilst drilling operations are underway.

Once all possible factual causes are identified, the law will seek to identify those that are relevant legally: not all factual causes are legal causes, and the relevant causation test depends on whether the claim in respect of the loss is a contractual claim or a (non-contractual) tort claim. The principal device of legal causation is 'remoteness', ie the question of whether the loss that has been suffered is, as a matter of law, too remote from the breach of contract or tort to be the subject of a claim.

1 In contract, if the loss in question is something that could reasonably have been within the contemplation of the parties when they negotiated the contract, then the loss will be recoverable.

2 In tort, the test is broader and requires only an enquiry into whether the damage was a reasonably foreseeable result of the breach. If so, it does not matter that the extent of the damage is unexpected or that it came about by a mechanism that could not have been predicted.

The reason for the broader test in tort is simple: contracting parties take time when contracting to consider possible eventualities and provide for them; a tortfeasor and his victim do not have that opportunity and will never have contemplated the tort. In the offshore context, this distinction is particularly important in personal injury cases. A contractor will have individuals employed and contracted by many entities on the rig or vessel at any one time, and so an injured individual might have only one contractual claim, but many tortious claims. What if that injured individual is airlifted to hospital for surgery, and the surgeons are grossly negligent in that they make the situation much worse and kill the patient, when his injuries were not originally life-threatening? As a matter of English law, the death of the patient may not have been caused by the original accident either in contract or tort: the supervening negligence, if sufficiently careless, 'breaks the chain of causation' and would be the legal cause of the patient's death.

Other jurisdictions

USA

State and Federal law in the USA have the same distinctions between contract and tort as English law.

However, in the USA, there tends to be a reluctance to allow intervening causes to break the chain of causation. Continuing the personal injury example used above, it is unlikely in the USA that the negligence of the surgeon would be sufficient to break the chain of causation and disconnect the original accident from the death of the individual. The party (or parties) originally liable for the injury would therefore be liable for the death of the individual, as medical malpractice in the USA is considered to be entirely foreseeable.

Mexico

Mexico has no specific concept of tort. Liabilities are classified as either contractual or extra-contractual, and the principles of causation and recovery are the same in both.

Only those liabilities that flow 'directly and immediately' from the breach will be recoverable. Every other intervening act will have its own consequences and the victim will have to pursue each negligent party individually. As such, Mexico sits at the opposite end of the spectrum from the USA and England in its approach to subsequent causes and breaks in the chain of causation.

China

The Chinese position is similar to that in Mexico; there is no distinction between causation in tort and contract. The test is one of reasonable foreseeability, although the horizon of foreseeability is more restrictive than that of England or the USA. In other words, and in common with Mexico, any intervening act including the victim's own failure to take steps to mitigate the loss, is likely to provide a defence to the claim. Medical malpractice for example would not be deemed to be a reasonably foreseeable consequence of the original breach and the chain of causation would be broken. As with Mexico, the victim will have to pursue each negligent party separately.

Conclusion

Causation is a basic and fundamental component of any legal claim, but the importance of the comparative considerations between types of claim and different jurisdictions can often be overlooked. When issues of causation do arise, they can cause a great deal of controversy and delay the resolution of the dispute. It is always advisable, therefore, to consider the type of claim at the outset and how it will be assessed depending on whether the claim is brought under a tortious or contractual cause of action. In relation to tort, whilst there is no opportunity to choose a favourable law and jurisdiction, knowledge of the different approaches taken to tort claims is essential in order to resolve them quickly and cost effectively.

The Brazilian Maritime Law Reform

Godofredo Mendes Vianna, Partner
Kincaid
+55 21 2276 6200
godofredo@kincaid.com.br

A new Brazilian Commercial Code is being considered which will provide an update to the code originally enacted in 1850. This article looks at the key areas of the reform affecting shipowners.

Background

Brazil is the largest economy in Latin America and the seventh-largest in the world, but it still struggles with bureaucracy and a very complex legal system that is not entirely up to date with international practice. The Brazilian Commercial Code – the main regulation relating to maritime law – was enacted in 1850 when Brazil was still under an empire regime, and Brazil often does not ratify international conventions related to shipping and carriage of cargo.

In 2011, a project of law for the enactment of a new Commercial Code was initiated before the Brazilian Congress. This project revoked the part of the current Commercial Code that remained in force, but in its initial draft, it did not include a single line in respect to maritime law. In response, the maritime sector has prepared a draft amendment to the project of law in order to include a section entirely dedicated to maritime law. The bill is still under analysis before the Brazilian Congress.

Main highlights of the reform

Time Bar

One of the most important aspects regulated by the new Commercial Code is the definition of the timebar period for claims arising out of a maritime carriage. Currently, this matter is often disputed before the Brazilian courts, with diverging interpretations regarding a one-year, three-year or even five-year time bar.

For the avoidance of doubt and to solve any controversy, the suggested amendment for the Commercial Code expressly provides for the applicability of a one-year timebar period for any claim arising out of the maritime carriage, thus bringing more legal security in respect to this matter.

Brazilian Consumer Code and the carriage of goods by sea

The draft for the new Commercial Code provides that, as a rule, the Brazilian Consumer Act does not apply in the carriage of goods by sea. This provision would solve several court disputes and would consolidate the understanding that is already adopted by the majority of the courts in Brazil, that the Consumer Act should not be applied when the service – of maritime transport – is used as part of the production chain of the particular industry or commerce.

Limitation of liability
In terms of limitation of liability on maritime claims, the 1850 Commercial Code did not bring any specific provision rather than the abandonment of the vessel. Subsequently, Brazil ratified the Brussels 1924 International Convention for the Unification of Certain Rules relating to the Limitation of Liability of Owners of Sea-going Vessels, but did not ratify the Hague-Visby Rules, the Hamburg Rules, the Rotterdam Rules or the 1976 London Convention.

The suggested update to the Commercial Code brings express provisions pertaining to the shipowner's limitation of liability, establishing procedures for the constitution of a limitation fund and providing similar limits as the ones provided by the 2012 amendment to the 1996 Protocol to the 1976 London Convention.

Such limitation would be applicable to injury or death during maritime operations, cargo losses, damage to third-party property and tort claims. However, the limitation would not be applicable to salvage, General Average, wreck removal, liability for environmental pollution, nuclear damages or crew wages.

Arrest of vessels
Brazil has not ratified the international arrest conventions of 1952 and 1999 and, in accordance with the Civil Procedure Rules in force, in order for a party to be able to arrest a vessel in Brazil, it is necessary to obtain jurisdiction of the Brazilian courts.

Hence, it is currently not possible to seek the arrest of a vessel in Brazil as a means of security for a claim subject to the jurisdiction of a foreign court. An arrest would only be possible in circumstances where the substantive claim and the merits of the case can be decided under the jurisdiction of the Brazilian courts. In order to soften these procedural requirements and align Brazilian law with some of the concepts applied internationally, the New Commercial Code will allow the arrest of vessels in Brazilian waters as a security for a foreign claim or dispute, as well as incorporating new provisions related to the arrest of sister ships, the arrest of bunkers and wrongful arrest.

Conclusion
The hope of the Brazilian maritime community is that, with the reform of the Maritime Law, Brazil will be more aligned with international practice and increase legal certainty for shipowners, charterers, cargo interests and insurers. This will have a significant impact on businesses and positively influence the country's domestic and international trade.

NOPSEMA

Nicholas Mavrias
Senior Claims Executive
+65 6506 2802
nicholas.mavrias@ctplc.com

The offshore oil and gas industry necessarily needs to comply with numerous regulations to manage the potential environmental impact of its operations. This article looks at one regulating body in Australia, and discusses the difficulties in complying with its requirements and the impact this could have on the industry in the current climate.

With the current repressed market for the offshore industry, many companies have had the unenviable task of taking drastic cost-cutting measures in order to remain in business. In such a market, one cannot lose sight of the importance of best operating practices, maintenance and safety, and the effect that cutbacks in these areas could have on the frequency and severity of incidents, and consequently on the environment. In spite of this, it is in the best interests of all players involved in the offshore oil and gas sector (oil majors, service providers, governments, etc) to ensure that regulatory mandates and directives do not impede the course of business. Overbearing regulations have the potential to put projects on hold, which, in the current climate, could lead to companies in financial constraints and jobs in jeopardy.

The situation in Australia

Australia has been hit hard by the downturn in the oil and gas industry. A number of projects have been delayed or put on hold as the prospective returns based on current oil prices do not justify the substantial financial investments. Despite the negative outlook, the country remains one of the most highly regulated jurisdictions. This position has come about through efforts to bring the country more effectively in line with other regimes throughout the world such as the USA, UK and the European Union, as well as a response to public outcries following the Montara incident in August 2009.

Inception of NOPSEMA

Since its inception in 2012, the National Offshore Petroleum Safety and Environmental Management Authority (NOPSEMA) has seen a far larger role/mandate than that of its predecessor NOPSA. It now represents a single, independent regulatory body responsible for the safety, well integrity and environmental management of the offshore industry in Australia. The aim is to standardise Australia's offshore petroleum regulation 'to a quality, best practice model', while striking a balance between regulation and industry.

A key role of NOPSEMA in ensuring a uniform regulatory framework is to review, assess and approve the titleholder's safety case, well operations management plan, offshore project proposal and environmental plan. Without these approvals, operations cannot begin.

There are two key areas in which NOPSEMA may have fallen short, the Environmental Plan requirement and the Financial Assurance requirement.

Environmental Plan (EP)

The review and assessment of the EP has seen the most scrutiny among titleholders, as it is felt that the assessment standards have not always been applied consistently. While the guidelines seem straightforward, according to one industry leading titleholder, most of the scrutiny is of the approval of the

According to its own guidelines, NOPSEMA must accept an EP if it is reasonably satisfied that it:

- is appropriate for the nature and scale of the activity or proposed use
- demonstrates that the titleholder has carried out the required consultation and details any measures that the titleholder proposes to adopt because of the consultation
- demonstrates that the environmental impact and risks of the activity will be reduced to as low as reasonably practicable
- demonstrates that the environmental impact and risks of the activity will be of an acceptable level
- provides for appropriate environmental performance outcomes, environmental performance standards and measurement criteria
- includes an appropriate implementation strategy and monitoring, recording and reporting arrangements
- does not involve the activity or part of the activity, other than arrangements for responding to oil pollution or monitoring the effects of oil pollution, being conducted in any part of a declared World Heritage property[1].

initial EP for an activity and what the consequences might be, eg oil spill impact, etc. This has been echoed by an operational review of NOPSEMA over a period of three years (2012-2014), which recommended, among other things, to

'[...] review adequacy of guidance notes and improve communication of the assessment process to ensure that industry understands the importance of the nature and scale [of risks] within the risk assessment process'[2].

As such, there has been some emphasis on trying to reach a shared understanding of the nature and scale of risks, and clarify expectations of risk assessment processes for approvals; however, the results of the review are unknown at the present time.

Financial assurance

Another issue that has raised some concerns lately among titleholders involves the financial assurance provision found in the Offshore Petroleum and Greenhouse Gas Storage Amendment (Compliance Measures No.2) Act 2013 (a product of The Commission of Inquiry into the Montara incident), which applies to all environmental plans or revised plans. In order to abide by said provision, it is stated that NOPSEMA must be satisfied that, should an incident occur, the titleholder will be able to draw on financial assurance to cover:

- costs, expenses and liabilities that may arise in connection with, or as a result of, the carrying out of the petroleum activity
- doing any other thing for the purposes of the petroleum activity
- complying with a requirement under the OPGGS Act, or a legislative instrument under the Act, in relation to the petroleum activity.

The financial assurance should be sufficient to cover the greatest reasonably credible costs and expenses of termination or control of the incident, and the greatest reasonably credible costs and expenses of operational response measures required for containment, clean-up and remediation of the environment. NOPSEMA has endorsed a method to calculate an adequate level of financial assurance developed by the Australian Petroleum Production & Exploration Association (APPEA). Problems arise because some components of the calculation are fixed over time, while many fluctuate on the basis of the market factors used in the estimate. For example, the daily hire rate for a rig spread, or the premium a contractor assigns to drill the relief well at the time is in constant flux and is impossible to predict with a high level of accuracy.

When taking into consideration that periodic audits of the financial assurance provision would also involve reviewing insurance certificates and company financials in order to demonstrate that the titleholder would be in a position to meet its financial obligations until the insurances could pay out, it does make the financial assurance provision difficult to meet. In these instances, any uncertainty may lead to environmental plans being rejected and projects being delayed or put on hold.

Summary

There is no doubt that, since its inception, NOPSEMA has been a major contributor in reducing the impact of incidents in Australia by standardising the country's offshore petroleum regulation 'to a quality, best practice model'. In such difficult times for the offshore oil and gas sector, it is more important than ever to manage both environmental and commercial expectations adequately. There should be a concerted effort to ensure that both industry and government maintain clarity and transparency in their dealings so as to reach a mutually beneficial outcome. We are confident that with an open dialogue, this outcome can surely be achieved.

1. Streamlining Offshore Petroleum Environmental Approvals. Program Report. p24
2. 2015 Operational Review Of The National Offshore Petroleum Safety And Environmental Management Authority, September 2015. Australian Government, Department of Industry and Science. p34

Incorporation by Schedule in Offshore Contracts

Andrew Lee, Partner
Hill Dickinson LLP
+65 6576 4722
andrew.lee@hilldickinson.com

Commercial contracts often incorporate terms from other documents, which can be in conflict with the main terms of the contract. This can cause problems for the courts and tribunals when trying to establish the parties' intentions. This article looks at some of the issues that can arise.

Incorporation of terms

It is increasingly difficult to find any commercial contract that does not seek to incorporate terms contained in a separate document. We perhaps see even more of this in EPC and OSV contracts than in other fields.

BIMCO contracts (for example) by their very nature require one to look to various different documents in order to find the intention of the parties. Supplytime 2005 has the boxes in Part I (which themselves make provision for the ever-present additional clauses), and the clauses in Part II, Annex A and Annex B. If that is not enough, very often the parties' own general terms and conditions, particular provisions or agreements for different operations, projects or geographical locations are also expressly incorporated. These additional provisions often give rise to difficulties in ascertaining what the parties have actually agreed, because there are inconsistencies between the terms of the contract and these additional provisions, which are often not tailored to the contract incorporating them, and not drafted with all of the other additional provisions in mind.

Interpretation in the courts

Generally, the English courts are reluctant to hold contract terms to be inconsistent with each other. The courts will try to put forward an interpretation that reconciles any potential inconsistencies while giving effect to the parties' intentions. However, where parties seek to incorporate terms from other documents or contracts on the basis of standard forms with special additions, it is even more likely to find terms that are truly irreconcilable. In such cases, the court will have to determine which clauses are to be preferred.

While lawyers make reference to the rules of construction, the English courts have been reluctant to set down many hard and fast rules as to how contracts should be construed or interpreted in such cases. Understandably, much of the guidance that has emerged is fact specific and constrained by the context of the particular case in which it was given. Nevertheless, some principles of wider application can be identified. For example, in a case where printed clauses on a standard form conflict with written or typed terms in a contract specially negotiated between the parties,

the latter are to prevail. Similarly, where a contract incorporates the terms of another document which conflict with the terms of the original contract, the courts have held that the terms of the original contract should prevail. The rationale underpinning these principles of construction seems to be that the terms specially negotiated by the parties must be taken to be those more likely to represent the parties' intentions.

Annexes

However, what we frequently see is that these additional provisions are identified as annexes, appendices or schedules to the contract, thus forming part of the contract itself, rather than provisions genuinely incorporated by reference. As such, where they conflict, we cannot necessarily simply cast them aside in favour of the provisions contained in the main body of the agreement when declaring what the parties' intentions must have been. What is to happen when a term contained in an annex cannot, on any reasonable reading, be reconciled with a clause in the main body? Governing law clauses nominating entirely different, or even marginally different, legal systems provide a prime example. Recently, we came across a dispute where the main body of the agreement stated that English law was to apply, while a term in the schedule stated that English law, 'as applied by [a South-East Asian jurisdiction]', was to apply. Quite what the latter provision actually meant in practice was another matter. Fortunately (or perhaps unfortunately from the perspective of developing the jurisprudence on this issue), the matter was superseded by other issues in the case and was never resolved.

Hierarchy clauses

Hierarchy or Order of Precedence clauses included in a contract, specifying which terms are to take precedence in a situation of conflict, go some way in helping the courts deal with this issue. However, recent decisions have shown that the courts will not jump at the chance to utilise such clauses, but will first try and do what they can to harmonise any inconsistencies between the terms. Taking Supplytime 2005 again as an example, such a term is included at the end of Part I:

'...in the event of a conflict of conditions, the provisions of PART I shall prevail over those of PART II and ANNEX "A" and ANNEX "B" to the extent of such conflict but not further'.

Incorporation by Schedule in Offshore Contracts continued

Not all contracts are blessed with such provisions, and those that are may include a hierarchy provision that does not cater appropriately for the particular conflict that arises. In a recent dispute arising out of an OSV charterparty, three annexes, each incorporating a different entity's standard terms and conditions, were attached to the standard form, each containing terms intended, to varying extents, to modify clauses of the main agreement. The main contract contained a hierarchy provision which provided that in the event of a conflict between the annexes and the main body of the agreement, the latter was to prevail, but it made no provision as to what was to happen if terms from the different annexes conflicted. The question arose as to whether the annexes should be read together as some sort of cumulative amendment to the main agreement. However, this approach of cutting and pasting terms from the different annexes together resulted in a most strained interpretation of the parties' intentions, especially as it was clear that the different annexes were premised on an unamended version of the standard form, not one amended by another annex.

A further difficulty arises when the main agreement and a schedule contain conflicting hierarchy clauses. This was the case in *Data Direct Technologies Ltd v Marks and Spencer Plc* (2009) EWHC 97 (Ch), where seemingly conflicting terms governing the payment of maintenance fees under a software licensing agreement arose. Ultimately and perhaps conveniently, the court did not have to confront the issue, instead putting forward an interpretation which, in its view, was able to reconcile the terms.

Summary

What is clear is that if one wants particular terms to be given effect, the best approach is to include them in the main body of the agreement, making sure that they do not conflict with any existing terms and removing the existing terms if they do. Incorporating by schedule or appendix will create more uncertainty than simply incorporating by reference. A well-drafted and comprehensive hierarchy clause can go some way to remedying this. However, where there are terms that conflict, there is always the possibility that they will be interpreted by a court in an unfavourable manner. Therefore, the safest option (much easier suggested than implemented) would be to ensure that all of the terms are synchronised correctly and, ideally, all are contained in the main body of the agreement.


PACIFIC RAIDER

Technological changes and emerging risks

Joseph Divis
Underwriter
+44 20 3320 8806
joseph.divis@ctplc.com

Sian Dinnadge
Underwriter
+44 20 3320 8967
sian.dinnadge@ctplc.com

The Standard Club has been writing offshore risks for over 40 years and in this period has had to adapt to the constantly changing landscape of risk. Such risks have been affected by political, economic, geographic, environmental and technological factors. This article focuses on how new technologies such as FLNG are affecting risk and how the club is evolving to ensure we can continue to provide suitable solutions for our members and their operations.

A changing landscape

Over the last 40 years, technological change has had a huge impact on risk in the offshore industry. Average sizes and values of offshore craft have increased dramatically in this period. Offshore supply vessels, which were once mostly ex-fishing trawlers, are now over 100m in length with accommodation capacity for more than 100 people. The *Pioneering Spirit*, the world's largest platform installation/decommissioning and pipelay vessel, is in excess of 400,000gt. Shortly due to commence operations on the Ichthys LNG Project offshore northwest Australia, Inpex's central processing facility (CPF)[1] will become the world's largest semi-submersible platform, measuring around 150 metres by 110 metres[2]. FLNG units are set to be the largest floating structures ever built and these increased sizes have implications on P&I risk through their enhanced personnel, pollution and wreck removal exposures.

Not only have vessels increased in size but also in complexity. This has widened the range of activities they are able to perform. Lifting capacities have been increased, allowing for larger, more valuable equipment and cargo to be transported, constructed and deconstructed. Activities such as decommissioning and new techniques such as High Temperature, High Pressure (HTHP) drilling and Enhanced Oil Recovery (EOR), aimed at increasing efficiency, will have their own impacts on risk. Also, whilst automation, robotics and the use of drones may

1 http://www.inpex.com.au/our-projects/ichthys-lng-project/ichthys-in-detail/project-facilities/central-processing-facility/
2 http://www.inpex.co.jp/english/ir/library/pdf/annual_report/inpex_annualreport2013_en-4.pdf
3 http://www.inpex.com.au/our-projects/ichthys-lng-project/ichthys-in-detail/project-facilities/central-processing-facility/

SBM's mid-scale FLNG concept (courtesy of SBM)

remove the human element from risks, they may also increase the operator's exposure to more recent threats such as cyber terrorism.

New designs

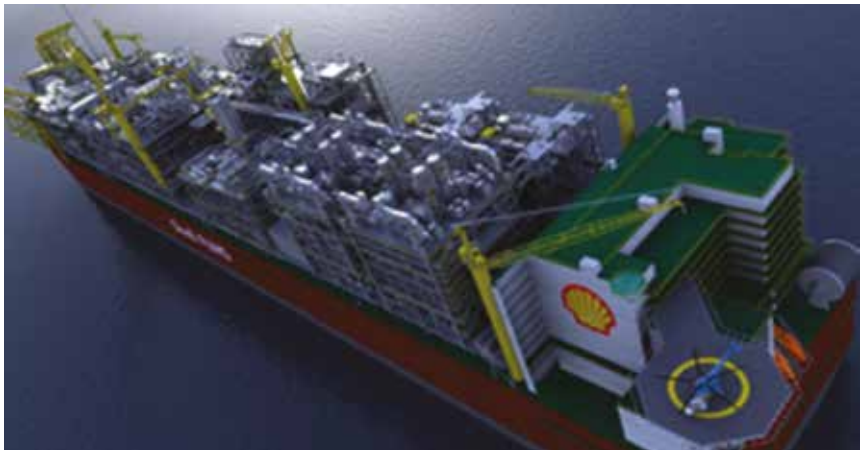
Technological advancements have enabled the creation of new and unproven ship types. Some of these designs have been driven by the need to reduce costs. With offshore structures being built further away from shore and a growing number of platforms operating unmanned, the market for specifically built 'walk-to-work' is growing. These vessels cut out the need for service and maintenance crews to be transported to and from shore every day, and thus are proving to be a cost-effective solution. Similarly, offshore wind turbines are being affected by the exhaustion of shore-side locations and are moving to deeper water, where floating wind turbines are becoming an increasingly suitable and economically sensible option. These come in a variety of designs including tension leg, spar buoy, semi-submersibles and even a 'Floating Power Plant', which combines wind and wave energy technology. Other new vessel designs include thermal energy conversion units, which harness energy through sea temperature differential, and Floating Nuclear plants, one of which, the *Akademik Lomonosov*, is currently under construction in Russia.

With the Fukushima disaster still fresh in memory, there are obvious concerns about such concepts.

Floating Liquefied Natural Gas

Perhaps the most discussed new offshore design is that of Floating Liquefied Natural Gas (FLNG) vessels and the industry eagerly awaits the start-up of Petronas's PFLNG 1, known as the *PFLNG Satu*, which is expected to be the world's first operational FLNG unit when it begins production offshore Malaysia in the coming months. This will be closely followed by Shell's far larger vessel *Prelude*, which is the result of an estimated $11bn investment. In fact, the capital expenditure for FLNG vessels is expected to amount to $35.5bn over the period 2015-2021[3].

Leading LNG players including Woodside, Shell, Petronas, ExxonMobil and Inpex are attracted to floating LNG options for a number of reasons. Fundamentally, oil and gas reserves are beginning to diminish, therefore alternatives are becoming increasingly attractive. This, coupled with political factors, has increased demand for the supply of cleaner and more environmentally acceptable sources of energy. As natural gas is the cleanest of all fossil fuels, it is no wonder that operators are considering FLNG as a viable option and investing heavily in the technology. FLNG technology



Prelude FLNG artist's impression (courtesy of Shell)

Technological changes and emerging risks continued

also enables LNG to be exported more directly to the market than current coastal facilities. This is because an FLNG unit will float above the offshore natural gas field and produce, liquefy and store the LNG until it is ready to be directly transferred to shuttle carriers, which will transport the produce straight to its required destination. This eradicates the need for long and costly pipelines that would otherwise be required to reach large reserves such as the Scarborough field and Brown basin, which sit 200km and 425km respectively offshore Australia. This also means that there is less marine and coastal environmental disturbance associated with the construction of coastal LNG facilities, and negates the steep costs associated with constructing infrastructure required for land-based projects.

Insuring the risks of FLNG

Notwithstanding the benefits of FLNG, as with any operation involving oil and gas, FLNG units are not without risk. The technology is new and unproven, which coupled with the immense size of some of these projects, represents new risks to insurers. However, many of the technical and operational challenges that FLNG units pose are akin to those associated with an FPSO, and with The Standard Club insuring over 40% of the world's active FPSOs, we are well placed to understand and rate the risk competently. Offloading oil/gas between two vessels on the high seas carries the risk of collision and pollution, storing LNG in tanks exposes the vessel to potential sloshing, which consequently may compromise the stability of the vessel, and of course there are risks of gas leaks and explosions associated with importing large quantities of high-pressure feed gas onto a floating facility. Perhaps the most notable P&I risk associated with FLNG is wreck removal due to the sheer size of such units. Shell's *Prelude* is wider than a Boeing 747, more than 500 metres long and will weigh 600,000 tonnes when fully loaded. We are yet to see how traditional salvors would be able to respond to a major casualty involving the wreck of a unit of this nature.

Although the Pooling Agreement does not specifically address the insurability of FLNG units, it has been determined by pooling partners (through the Production Operations and Specialist Craft Sub-committee) that FLNG units are akin to FPSOs in terms of risk and will be considered in the same light by the International Group. This means that they are capable of having poolable cover whilst navigating but are excluded by virtue of the drilling and production exclusion whilst engaged in operations in connection with gas production. As with FPSOs, The Standard Club is able to offer a poolable solution whilst navigating and a non-poolable solution under our Standard Offshore Rules (SOR) when the unit is in field and operating. This can be provided to a limit of $1bn, which is the highest available in the International Group. SOR cover responds to a member's liabilities in respect of personal injury, pollution from unit, removal of wreck, collision, fixed and floating objects, and fines.

The cover can also respond to a member's contractual assumptions of liability should these arise out of a covered risk (subject to prior approval of contract).

Conclusion

The Standard Club endeavours to stay one step ahead of technological advancements in the offshore industry and is enthused to be a part of the changes. We will ensure our technical understanding is second to none and that we offer cover solutions to members venturing into untried and tested areas of operation where possible.

Web alerts The Standard Club issues a variety of publications and web alerts on topical issues and club updates. Keep up to date by visiting the news section on our website www.standard-club.com

@StandardPandI
The Standard P&I Club

This bulletin is published on behalf of The Standard Club Ltd by the managers' London agents: **Charles Taylor & Co. Limited** Standard House, 12–13 Essex Street, London WC2R 3AA, UK Registered in England No. 2561548

Telephone: +44 20 3320 8888
Emergency mobile: +44 7932 113573
E-mail: pandi.london@ctplc.com
Website: www.standard-club.com

Please send any comments to the editors, Hannah Griffiths
E: hannah.griffiths@ctplc.com T: +44 20 3320 8846
and Cristine Christodoulou
E: cristine.christodoulou@ctplc.com T: +44 20 7522 7507

The Standard Club Ltd is regulated by the Bermuda Monetary Authority. The Standard Club Ltd is the holding company of The Standard Club Europe Ltd and The Standard Club Asia Ltd. The Standard Club Europe Ltd is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. The Standard Club Asia Ltd is regulated by the Monetary Authority of Singapore.