MIND THE GAP: NAVIGATING LEGAL RISKS IN YOUR TYPICAL FPSO PROJECT

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Introduction

This article focuses on the typical contracting problems which arise during the construction and installation phase of a FPSO project. The Article, however, is not focused on the contract between the shipyard and the FPSO owner. There are multiple contracts that typically feature in the wider FPSO lease/charter model; all of which are relevant. The lease/charter and the operations and maintenance agreements have to be considered. There are also the contracts dealing with a range of obligations from design, conversion/newbuild, module fabrication, vendor subcontracts for various equipment, logistics and tow.

The typical problems arising in such projects are primarily two fold. First, the contracts used are rarely adapted to cater to the particular features of the project. Second, there is usually very little coordination in the web of contracting relationships common in such projects. These issues create a fertile ground for uncertainty, cost increases and delays. In the subsequent lease and operation phase, the project will face different challenges. For reasons explained below however, the contracts from the construction and installation phase will continue to have an impact during the lease and operation phase.

With the recent positive announcements regarding various new FPSO projects, it is timely to relook the common issues in the construction and installation phase contracts and consider how best to deal with them going forward.

Empowering and coordinating the contracts

Whilst it is impossible to contract for every eventuality, it is possible to contract for what is important and anticipated. The contracts should empower each party to do what is necessary to minimise costs, reduce delays and increase certainty on how foreseeable problems should be dealt with. Some selected key risks are identified below with recommendations on how best these should be handled.

Managing time risks

The project schedule which will be of primary importance is the one agreed in the lease/charter agreement. When the various contracts with the FPSO owner, shipyards, module fabricators, logistics providers and equipment manufacturers are initially negotiated, this time schedule is likely to be a reference point.

Given the high likelihood of time slippages in project delivery for FPSOs, the contractual provisions dealing with delays, whether through extension of time, liquidated damages and/or termination of contract, are critical. The reality however is that termination is not a viable option for most if not all FPSO projects. This is because all equipment and work has already been tailored to create a bespoke unit for a particular offshore field. Liquidated damages may well also be of little comfort for either the shipyard or the FPSO owner facing late deliveries because they may not compensate for the total actual loss arising from such delays.

In these circumstances the contractor facing the delays (either the shipyard (with their vendors and sub-contractors) or the owner (contracting with the shipyard or their vendors or sub-contractors)) will need contractual rights to effectively keep the project on track or minimise delays. Some contracts do contain provisions on acceleration and/or a scheme for taking over any uncompleted parts of the work – but not all do. Less attention is sometimes paid to contract terms of vendors contracted to supply significant equipment (which effect the critical path). On occasion, this equipment is purchased on pre-existing company purchase order forms and spread across multiple purchase orders. These purchase orders are unlikely

to have any provisions of any real assistance to a party looking to manage increasing delays.

To deal with delays arising in an FPSO project holistically, all related contracts should have rights to demand expedited works and take over works. Consideration should be given to circumstances where rights are needed to remove a partially completed FPSO or vendor equipment from countries known for bureaucracy. For this, the contract should specifically identify what local approvals are needed from relevant government authorities to export the works. In addition, bespoke contract terms should be drafted to cater to events of delays caused by both contracting parties, or even third parties, which may affect the critical path of works.

Protecting Multi Party Rights

It is typical for there to be multiple contracting parties in a single FPSO project, with many companies from a single group entering into various contracts. This is done for a host of reasons ranging from tax considerations to local content compliance.

This can create difficulties in the event that a group company suffers a loss, but that same company is not the contracting party to the contract under which the loss is *prima facie* claimable. Under English law, if there is no privity of contract, it is extremely difficult for a third party to enforce a contractual term. Coupled with this issue, it might be the case that a group is reluctant to disclose in an arbitration their internal accounting procedures and inter-company structure to prove losses. As such, the potential right to claim losses becomes harder.

There are also warranties for the FPSO and the various types of equipment installed to consider. A warranty given to one company in the group may well have to be assigned or novated to another group company. These assignments and novations will have to be properly valid under the laws of the relevant contracts.

Another significant and often under appreciated issue is the operation of the multi group indemnity clauses spread across the multiple contracts. These indemnities not only cover the usual death, personal injury and property damage, but also increasingly include onerous indemnities for pollution, fines, sanctions and anti-corruption. Not all contracts have consistent and uniform indemnity wording. Some contracts require certain preconditions to be met in order for a subcontractor or vendor to be qualified as part of a group, failing which they will not be considered as such. As such, without proper and consistent drafting in the related contracts, it may not be possible for parties to fully benefit from the relevant indemnities.

In the event of a dispute, with a common set of facts, but in relation to obligations spread across multiple contracts, it will be important for the contracting parties to be advised with certainty what their legal rights are and what their exposures may be. In order to achieve this, at the minimum, each of these contracts must have the same law and arbitration clauses. It is unfortunately often the case that each of the contracts have different law and arbitration clauses such that a group of companies can find themselves having to potentially resolve such disputes by reference to laws of different jurisdictions.

Dealing with Damage or Loss to or loss of Equipment and the Consequences

If there is any damage to the FPSO or equipment, it is often the contract between the shipyard and the FPSO owner that properly works through all eventualities arising from this. Where however the party responsible for the damage is not a contracting party to the main FPSO contract, there may be problems as to how the loss can be claimed and passed on under the relevant contracts. This problem is exacerbated when the ancillary contracts e.g. those with vendors and logistics providers, do not contain a contractual scheme to claim for such losses.

Unless set out in clear contractual terms, it is dangerous for parties to assume that an insurance placed by one party, which names all parties as co-assured, will deal with everything. Under English law, parties cannot assume that an agreed joint names insurance provision would automatically create an insurance funded liability regime which will exclude parties' rights to claim from each other for negligence or breach of contract. If parties expect the insurance to respond to certain events, to the exclusion of other rights between the parties, then this understanding must be set out clearly in the contracts. The contract form may well already have standard knock-for-knock indemnities which are simply kept in by the parties without appreciating that this standard allocation for property damage may militate against what parties believed might happen when there is damage to equipment. A potential additional layer of uncertainty arises when there is more than one insurance, each taken out by different parties and there is no contractual agreement in respect of which insurance responds to the actual event.

If risk allocation is not clear and when such an event occurs there will be arguments between the parties in respect of whether the insurance responds (and if so which one) or if a party should be directly liable.

Is the 'Standardisation' of Contracts the Answer?

At the 2016 Global FPSO Forum in Galveston Chanaka delivered a paper on standardisation of contracts in which he theoried that: if a 'one size fits any project' style contract can be developed, the rewards would be enormous - faster contracting, savings in cost and maintaining good relations with predictable risk allocation. There are a range of provisions which will need to be developed and negotiated to fit the project. Typically these are design risks, change orders, changes in law, force majeure, warranties, delivery/ mobilisation, payment, termination, limitations, exclusions and applicable laws. The reality is that a FPSO project is complex, so each of these provisions will require consideration not only in the particular contract, but

also they will need to be coordinated across the various contracts.

Concluding Comments

There are of course many more risks which need to be managed in the contracts from the construction and installation phase. Notable ones include design risks and coordination / integration risks, each of which can be the subject of its own article, and which also impact upon the lease and operation phase.

This article is not proposing that the existing contracts should be discarded and entirely new documents be produced. Instead, it is suggested that individual contracts should not be drafted in isolation as this will create gaps between the contracts and parties will run a real risk that the contracts will not provide any practical solutions to foreseeable problems. Whatever contract forms are used to negotiate, they should be adapted to the project and to the other contracts that work in parallel with it.

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