Offshore

March 2015

OFFSHORE BULLETIN

Welcome to the March 2015 edition of our Offshore Bulletin.

The tragic incident on board the *CIDADE DE SAO MATEUS* off Brazil and the fire on the *PETROJARL KNARR* are reminders to the industry that there are continuing uncertainties in relation to the legal and regulatory issues concerning offshore units. Fortunately, the incidents are not on the same scale as *DEEPWATER HORIZON*, in which the Texas Supreme Court has recently delivered its long-awaited ruling on whether BP was entitled to coverage of US$750 million under Transocean's insurance policies as an additional insured (see our June 2013 and June 2014 Bulletins). With the assistance of David Sharpe of Lugenbuhl, Wheaton, Peck, Rankin & Hubbard, we look at the Court's reasoning in reaching the conclusion that BP was not so entitled.

We also discuss the English Court of Appeal's recent decision in the *OCEAN VICTORY*, which confirms that where parties have taken out joint insurance, it is likely that their insurers will be precluded from exercising rights of subrogation in the event of a breach resulting in an insured loss.

In the run-up to the recently postponed Nigerian elections, analysts have observed that pirate activity typically spikes before national elections, and conjecture that this may be due to some local politicians funding their election campaigns with the proceeds of piracy. In light of this speculation, we examine recent pirate activity in the Gulf of Guinea and discuss the potential implications.

With the assistance of leading barrister Simon Rainey QC, we look at a recent English Commercial Court decision which confirms the restricted scope of risk allocation provisions in rig hire contracts, highlighting that a party will not (in the absence of an express term to the contrary) be able to benefit from its own breach of contract. We also consider another recent decision of the Commercial Court which discusses unreasonable withholding of consent and the meaning of "operating expenditure".

If you require any further information or assistance on any of the issues raised in this edition, please do not hesitate to contact any of the contributors or your usual contact at HFW.

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Is an FPSO a ship?

The explosion and tragic loss of life on board the *CIDADE DE SAO MATEUS* and the recent fire on the *PETROJARL KNARR* are timely reminders of the considerable legal and regulatory issues faced by the owners, charterers, operators and insurers of FPSOs and other floating offshore units.

Amongst these issues is the question of whether or not FPSOs are subject to the laws and regulations that apply to "ships". The consequences of this question being decided one way or another are potentially very significant. For instance, the main international maritime conventions that permit limitation of liability apply to "ships". If an FPSO falls within that definition, its owners may be entitled to limit their liability in certain jurisdictions in the event of a serious casualty. Limitation would not, however, be available if an FPSO is not a "ship".

Whilst there have been no significant recent developments on this point, there have been some interesting decisions concerning the definition of "ship". In particular, the United States Supreme Court decided that a floating home was not a "vessel" under Federal maritime law, which meant that it could not be arrested. This decision, which contains a useful review of the relevant legal principles in that jurisdiction, has broader application and was more recently followed in a case concerning the sinking of a floating drydock.

Almost three years ago, HFW issued a detailed briefing on these issues, which was subsequently published in the International Oil & Gas Journal, which can be found here: http://www.hfw.com/FPSO-legal-and-regulatory-issues-Sept-2012.

Recent events highlight the need for all participants in offshore projects involving floating units to understand these complex legal issues and their potentially serious financial implications.

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Recent events highlight the need for all participants in offshore projects involving floating units to understand these complex legal issues and their potentially serious financial implications.

PAUL DEAN, PARTNER

Update: BP loses right to US$750 million additional insurance

In a ruling delivered on 13 February 2015, the Texas Supreme Court (answering a certified question from the US Fifth Circuit of Appeals[1]) held that BP is not entitled to coverage under Transocean's insurance policies in respect of the *DEEPWATER HORIZON* spill.

The Court reasoned as follows:

Transocean's insurance policies required reference to the Drilling Contract to determine BP's status as an additional insured.

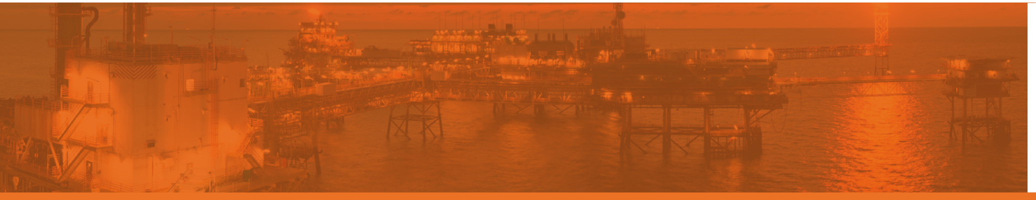
As when construing any other contract, the Court must examine the policy's language in determining the extent to which, if any, it should look to an underlying service contract to ascertain the existence and scope of additional-insured coverage. There is no need for "magic words" to incorporate a restriction from another contract into an insurance policy; it is enough that the policy clearly manifests an intent to include the contract as part of the policy.

BP was not named as an additional insured in the Transocean policies or certificates of insurance, but the policies provided additional-insured coverage only "where required" and as "obliged" by the Drilling Contract, so coverage was conferred by reference to the Drilling Contract.

The Drilling Contract imposed limitations on BP's coverage as an additional insured.

The Drilling Contract provided *(inter alia):*

1 In re *DEEPWATER HORIZON*, 728 F.3d 491, 500 (5th Cir. 2013); and http://www.hfw.com/Offshore-Energy-Bulletin-June-2013; and http://www.hfw.com/Offshore-Bulletin-June-2014



The Supreme Court held that, in the context of the Drilling Contract as a whole, BP's construction was unreasonable, and Transocean's construction was the only reasonable one.

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"[BP] ... shall be named as additional insureds in each of [Transocean's] policies, except Workers' Compensation for liabilities assumed by [Transocean] under the terms of this contract." (Emphasis added)

The only reasonable construction of this provision was that BP's coverage as an additional insured was limited to liabilities Transocean assumed in the Drilling Contract.

Transocean argued that the italicised wording imposed a limitation on the general insurance obligation corresponding with Transocean's contractual indemnity obligations.

BP on the other hand argued that the restriction applied only to Workers' Compensation insurance, since there is a comma before, but not after, the phrase *"except Workers' Compensation"*.

The Supreme Court held that, in the context of the Drilling Contract as a whole, BP's construction was unreasonable, and Transocean's construction was the only reasonable one. The Court added that *"We will not construe the absence of a comma to produce an unreasonable construction"*.

It followed that BP was an additional insured under Transocean's policies only to the extent of the liability assumed by Transocean, and was therefore not entitled to coverage for damages arising from subsurface pollution (for which BP had expressly assumed responsibility in the Drilling Contract).

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hfw ...and the English Court of Appeal confirms that joint insurance precludes subrogation rights

In the recent decision in the *OCEAN VICTORY*[1], the Court of Appeal held that the port of Kashima in Japan was not unsafe, and that consequently the demise charterers could not recover damages for breach of the safe port warranty from their time charterers. Whilst not strictly necessary, the Court went on to discuss an important issue of principle raised, namely the "recoverability issue".

The demise charterers had brought a claim in the amount of US$137.7 million against the time charterers in respect of the demise charterers' alleged liability to head owners arising out of the casualty. Clause 12 of the demise charter (on the BARECON 89 form) required the demise charterers to effect and pay for marine, war and P&I insurance in the parties' joint names.

The Court examined previous authorities and found that even where there is no provision for joint insurance, but the insurance is paid for by one party for both parties' benefit, the insurance will be held to cover that party's liabilities, and there will be no rights of subrogation. It follows that where, as in the instant case, the parties *have* agreed to take joint insurance, this is even more likely to evidence an agreement to exclude rights of recovery by one party against the other in respect of insured losses.

The fact that the demise charterers had paid for insurance for their own and the owners' joint benefit showed

1 *Gard Marine & Energy Ltd v China National Chartering Co Ltd and others* [2015] EWCA Civ 16 and http://www.hfw.com/Abnormal-occurrence-clarified-in-the-OCEAN-VICTORY-Court-of-Appeal-decision-January-2015

The Court examined previous authorities and found that even where there is no provision for joint insurance, but the insurance is paid for by one party for both parties' benefit, the insurance will be held to cover that party's liabilities, and there will be no rights of subrogation.

that the parties intended insured losses to be compensated by that insurance. Accordingly, even if the demise charterers *had* breached the safe port undertaking, the owners had no rights of recourse against the demise charterers in respect of insured losses, and consequently the owners' insurers had no rights of subrogation against the demise charterers. This in turn meant that the demise charterers, having no liability to the owners, had suffered no loss which they could pass on to the time charterers down the charterparty chain.

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hfw Nigeria: two trends – a perfect storm?

The ruthlessness and audacity of the terrorist group, Boko Haram, in Nigeria's north has received a lot of recent press coverage. Attacks by the group, until recently focused in Nigeria's north-east, have expanded to neighbouring Cameroon and Chad. Further south, however, in Nigeria's coastal waters, two developing trends will be of greater concern to the shipping community.

Late last year, The Economist magazine, in an article titled *"The Ungoverned Seas"* discussing the nature and threat of piracy off Nigeria and in the Gulf of Guinea, referred to the view held by analysts who study the region that pirate activity tends to spike just before national elections. The suspicion is that some local politicians may be financing their campaigns with the proceeds of piracy. The Nigerian national elections, originally scheduled for 14 February 2015, have been postponed until 28 March 2015 in order, the Government says, to secure voters in the north against the threat of Boko Haram. If the analysis is correct that ransoms and stolen cargo are used to fund elections, then the postponement of the elections is a cause for concern for vessels operating within the Gulf of Guinea .

TradeWinds has already reported a spate of pirate attacks in the Gulf of Guinea in February, including one that left a Greek officer dead with three crew members abducted and another, a successful hijack of the fishing vessel, *LU RONG*.

Given the level of pirate activity and the potential for a spike, the warning, this month, by the Nigerian Maritime Administration and Safety Agency (NIMASA) that it will not hesitate to detain vessels entering the country's territorial and coastal waters with security escorts on board, whether armed or unarmed, muddies already murky waters and does little to calm the nerves of those operating in the Gulf of Guinea. NIMASA issued this warning shortly after the detention of three vessels for sailing into Nigeria with individuals linked to private security companies (PMSCs) on board. PMSCs operating in Nigeria generally agree Memoranda of Understanding (MoUs) with the Nigerian authorities. However, NIMASA, following the detention of the three vessels, called into question the legality of some MoUs, commenting that *"Private registered security firms in collusion with unscrupulous officials have embarked on unconstitutional MoUs and partnerships that threaten our national security"*.

Offshore operators, particularly vulnerable to pirate attacks, including low freeboard supply vessels, have complained about the lack of security when operating in this region.

TUNDE ADESOKAN, ASSOCIATE

Clarification is needed from the authorities on the status of MOUs and the precise activities thereby authorised. NIMASA further needs to clarify the position of unarmed security personnel and other guards provided by the authorities (both police and navy) including jurisdictional issues which have sometimes arisen between the Navy and Marine Police. Absent such clarification, further detentions in the immediate future are not unlikely.

Offshore operators, particularly vulnerable to pirate attacks, including low freeboard supply vessels, have complained about the lack of security when operating in this region. They now face potential detention by the authorities due to steps taken, in their view legitimately, to protect vessels and crew with the attendant cost and expense.

While the safety of human life must remain paramount, offshore operators would be well advised to ensure that contracts signed with guard companies spell out which party is responsible for the time and expense arising following detentions, as well as for fines imposed by authorities which may be excluded from standard P&I Club war risk cover.

Tunde Adesokan is a Nigerian working from HFW's London office and has been involved in several detentions by West African authorities in recent years.

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Transocean Drilling UK Limited v Providence Resources PLC (the Arctic III)[1]

The English Commercial Court has recently confirmed the restricted scope of risk allocation provisions in rig hire contracts, and has emphasised that, in the absence of an express term to the contrary, a party will not be able to benefit from his own breach of contract.

Transocean provided the rig GSF ARCTIC III to Providence pursuant to a drilling contract which set out a scheme of different daily hire rates to apply depending on the function the rig was performing at any given time. Delays arose during the performance of the contract, caused by Transocean's failure, in breach of the contract, properly to maintain the rig. Providence refused to pay hire for periods of delay caused by Transocean's breach. Transocean argued that the contract provided a complete code and one of the different daily rates was to be applicable in all eventualities, irrespective of a breach by Transocean.

The Court rejected Transocean's argument. Express terms allocating the risk of one party's negligence to the other party, such as knock-for-knock clauses, are fairly common in rig hire and offshore vessel contracts. However, when the risk of a particular event is not expressly allocated by the terms of the contract, the presence of knock-for-knock clauses elsewhere in the contract does not give rise to any special principle of construction whereby the parties to such contracts can be considered more likely than others to be willing to bear the financial consequences of the other party's breach.

The Court went on to apply the general presumption of contractual interpretation that neither party

Transocean argued that the contract provided a complete code and one of the different daily rates was to be applicable in all eventualities, irrespective of a breach by Transocean.

JENNY SALMON, ASSOCIATE

intends to abandon any remedies for breach unless clear words to the contrary are used. There were no such contrary words in this case. Indeed, the remuneration clause framed the remuneration obligation as being in return for "the WORK", which indicated that there was no intention to pay during periods when work was not being performed.

This judgment shows the Courts' unwillingness to read an all-inclusive risk allocation regime into a rig contract where such a regime would have denied the hirer a remedy for the owner's breach. If a party to a rig contract wishes to allocate the risk of his own negligence or breach to his counterparty, he will need to use very clear contractual language to do so.

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1 [2014] EWHC 4260 (Comm)

hfw Commercial Court considers meaning of "operating expenditure" and unreasonable withholding of consent[1]

Pursuant to a Transportation, Processing and Operating Services Agreement (TPOSA), Talisman (operators of the Ross Field, a hydrocarbon accumulation on the UK Continental Shelf) agreed to provide transportation services to the adjoining Blake Field (operated by BG). The services included the use of a Floating Production, Storage and Offloading unit (FPSO) that was already providing services to the Ross Field. BG initially paid for the services by way of an oil tariff, and subsequently by way of a contribution to "operating expenditure".

A dispute arose as to the amount of operating expenditure charged under the TPOSA. This involved a detailed analysis of the meaning of "operating expenditure" within the terms of the TPOSA. Whilst the decision is restricted to the facts of this particular case, the Court took a broad view of the meaning of "operating expenditure", favouring a commercial construction by which all expenses incurred by the FPSO in relation to the Blake Field would be for BG's account.

A further question was whether BG's prior written approval was necessary if a change in Talisman's payment obligations would lead to increased operating expenditure or have a material adverse impact on the services provided under the TPOSA. The relevant clause required *"such approval not to be unreasonably delayed and/or withheld".*

In the circumstances, the Court found that Talisman should have sought BG's consent to change the payment obligations. If no consent was sought, or consent was sought and unreasonably withheld, damages would be assessed based on the loss caused to BG by Talisman agreeing such changes without their consent. If consent was withheld reasonably, there would be no breach.

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The Court held that Talisman's *"reasonable belief"* that the changes would not affect either the Operating Expenses or BG's material position was irrelevant. Instead, the circumstances in which BG's consent was required depended on an objective assessment, i.e. whether on the balance of probabilities the changes would have such effects.

In the circumstances, the Court found that Talisman should have sought BG's consent to change the payment obligations. If no consent was sought, or consent was sought and unreasonably withheld, damages would be assessed based on the loss caused to BG by Talisman agreeing such changes without their consent. If consent was withheld reasonably, there would be no breach. The Court held that the burden of proof rested with the party attempting to show that consent has been unreasonably withheld.

The case also confirms the principle that if consent is not sought there can be no withholding of consent, let alone an unreasonable withholding of consent. For more on this topic, and in particular for further commentary on the meaning of *"such approval/ consent not to be unreasonably withheld"*, please see our Briefing which can be found here: http://www.hfw.com/Good-faith-honesty-and-reasonableness-December-2014.

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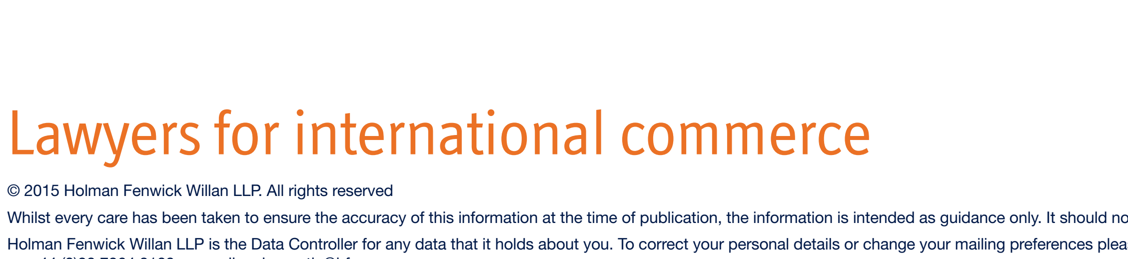
1 *BG Global Energy Ltd and others v Talisman Sinopec Energy UK Ltd and others* [2015] EWHC 110 (Comm)

Conferences and events

Offshore Technology Conference 2015
Houston
4–7 May 2015
Attending: Paul Dean and Jonathan Martin

ACI – Offshore Support Vessels Summit
Aberdeen
17–18 June 2015
Presenting: Paul Dean
Attending: George Eddings



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