

BETWEEN THE DEVIL AND THE DEEP BLUE SEA: STACKING NOW AND THE UNKNOWN FUTURE



Introduction

Owners of offshore rigs, FPSOs and all other offshore support vessels are doing their very best in what is a challenging and unpredictable market. The prolonged weak oil prices may be on the rise, however, commodity prices remain highly variable.

As a result, there continues to be an over supply of units - an irreconcilable problem for at least a year or more now. Even if there is an increase in oil prices, it will need to be sustained over a long period in order to put the current oversupply of units back to work. In light of these conditions, many of these units have been stacked for a lot longer than was perhaps anticipated.

This article is, to some extent, an attempt to look into the crystal ball.

Terminology

For the purposes of this article, the following terms will be used:

Charterer – the potential end user, often the ‘operator’.

Owner – the owners of the rigs and vessels, also known as ‘contractors’.

Unit – a drilling rig, barge or other types of offshore vessels.

Two types of **stacking** will be considered in broad terms, warm stacking and cold stacking.¹

¹ While it is understood that the description ‘lay up’ is also used in the industry and within warm and cold stacking, there are potentially further sub divisions.



The reality

- Units are being stacked in unprecedented number around the globe.
- Brand new units are often stacked straight from shipyard, or kept in lay up space at the shipyard until the unit can be chartered.
- The typical and minimum charter contract guarantees and warranties required for units generally remain un-amended.
- That these guarantees and warranties only grow more onerous for an Owner the longer its unit has been stacked.

Shedding light on the unknown future

From these known fixed points above, we have assessed the likely future for any owner of stacked units and the challenges they face in marketing and chartering the next anticipated hire.

Stacking is nothing new, or is it?

Warm stacking of units have been carried out frequently by owners for years, where they make interim arrangements whilst the unit is awaiting an imminent new charter. The unit is likely to be reactivated at short notice therefore it requires to be 'service ready' for when the charter starts. There may be a 'core crew' onboard carrying out repairs and/or keeping the unit maintained. The full crew will be available for services at short notice and the unit is actively marketed. The operating costs for warm stacking are therefore often very similar to costs during operations. This temporary

idling is not uncommon between projects, even where there is a high demand for units in the market.

The cold stack is a different creature. In preparation for a cold stack, the crew - or a good many of them - may unfortunately be made redundant or transferred to crew other units in the owner's fleet. A skeleton crew is maintained onboard or the cold stacking services may be provided by a third party contractor. What needs to be done during the cold stacking period will depend on the unit and the equipment onboard. It might be the case that routine maintenance is deferred during cold stacking to reduce or delay cost expenditure. A much longer lead time will also be required to reactivate, with the unit likely to require a full Class certification amongst other things.

Beyond the conventional stacking of operational vessels, another factor has now come into play in this market. It is no longer uncommon for a brand new next generation unit to be stacked direct from launch at the shipyard. Rather than the established maintenance regimes of an aged unit, the level of checks and maintenance required for a new unit that is stacked is likely to be bespoke. It is also likely that none of the equipment onboard the unused units will have been tested beyond sea trials and therefore may struggle to offer guarantees beyond those provided by the shipyard/original equipment manufacturer.

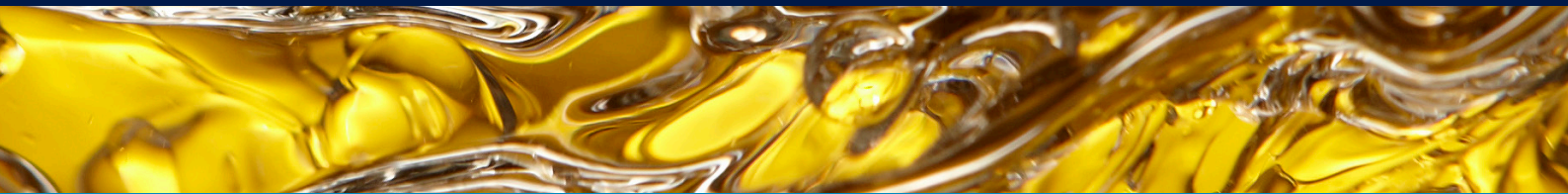
Is your unit coming out of stacking? Key considerations

Contractual Guarantees and Warranties: Charterer's Specifications / Scope of Work

The tender negotiation for the charter of a unit, irrespective of the state of the market, is a competitive process. Any owner will be more than familiar with the detailed specification/scope of work that forms part of a tender package.

While there are many other requirements in a tender, the items below are likely to have greater relevance for a unit coming out of a stacking, particularly where it may not have been operational for a year or even more. A unit is generally required to demonstrate its ability to comply with or exceed:

- A comprehensive range of industry standards and guidelines, as well as national regulatory requirements, which are typically expressed as being for an owner's 'guidance' only. The expectation being that these a minimum threshold of the charters expectation.
- Various minimum performance criteria, which will include detailed design and engineering requirements.
- A high level of integration and coordination with the other units and vessels active in the field.
- A detailed mobilisation procedure, setting out the various surveys and approvals that are required by Class and possibly other regulatory bodies.



The costs involved in ensuring that a stacked unit can comply with tender environments is therefore something of a gamble for owners. An owner may consider whether they can recover such costs in as part of their bid however this is likely to be the least of their concerns. The bigger problem is ensuring the stacked unit is successfully contracted out in the face of a market crippled by oversupply.

In our view

A stable oil price in 2017 can only raise confidence in the offshore contractor market; but the effect will not be immediate. It takes a lot longer for the benefit of an increase in the price of a barrel to be felt by the supply chain when compared to the drastic effects of a decline. The lag between capital investment from oilfield owners and the units being chartered means that a unit stacked today, may only be chartered out in 2018. Between now and then a lot can happen, both to the condition of the unit and the requirement of its potential charterer.

Charterer's Specifications – Then and Now

A charterer will continually review, revise and improve the requirements in their tender package. This is standard practice. In this market, any potential charterer is likely to have the upper hand in any negotiation with an owner - and probably the pick of the litter. So it seems unlikely that an owner can negotiate away such demands.

While Class notations will remain the same, Class requirements will change as they are constantly under revision



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and improvement. These will form part of the contractual guarantees and warranties that the owner's unit will be required to comply with.

The charterer may also simply require a 'change' in the requirements to the operation of the unit, which may not necessarily be an 'improvement' or 'increase' of the existing standards. During the last 18 months, charterers have drastically eliminated any expense from the supply chain, with the aim to keep costs at a reduced level and avoid further 'boom and bust' cycles. In addition, regulatory requirements continue to evolve in various jurisdictions, particularly with respect to work in the Gulf of Mexico and the North Sea. What has also become the norm (rather than the exception) is enhanced regulatory oversight in relation to safety, operational and environmental concerns. The variability

and continued evolution of these regulations creates a challenging environment in which to reintroduce a older unit into the commercial market.

In our view

In order to comply with these new contractual guarantees, warranties and regulatory requirements, the unit which is stacked will require some level of further design, engineering and testing before it can be tendered into service. Hindsight is a wonderful thing, but owners should consider this point when considering what upgrades and maintenance should be carried out during stacking. Incurring capital expenditure on refurbishment that may seem critical now may be redundant by the time the unit is chartered.



Policy Events and Procedural Effects

The offshore oil and gas industry is like any other. It reacts swiftly to industry events and its effects can be seen in the contracting and insurance risk allocation. An obvious example of such an event was the Piper Alpha disaster. The Cullen Report that followed the tragedy fundamentally changed the industry approach to safety (beyond the UKCS) and also to contracting (in particular, the way in which indemnities were negotiated, structured and agreed).

As such, when a unit comes out of stacking, any charterer would expect its Owner to be able to demonstrate compliance with the regulatory requirements of the jurisdiction (or often more stringently, the charterer). Thus the physical condition of the unit is not the only asset that requires to be maintained. Like the revisions to the charterer's specifications/scope of work, it is foreseeable the policies and procedures of the stacked unit will be required to be overhauled before it is put into service.

Operational status

Even if the stacked unit perfectly complies with what is expected by the charterer, it's possible that when the unit comes out of stacking, not all of the systems will work. Such issues are often only discovered when the unit is being 'defrosted' from cold to warm stacking and further refurbishment and reinstatement work may be required. The prospect of this may increase further the longer the unit has been



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stacked. The charterer is likely to anticipate this possibility and seek to build that into their contracting.

If significant repairs or refurbishment are required, the charterer may insist on reduced rate structures, broad warranty obligations and/or a contractual right of termination during the mobilisation stage. This will not sit well with the bankers. For example, original equipment manufacturer warranties and service intervals may have to be reinstated, which could cause further delays and additional costs that the charterer and owner had not considered. For obvious reasons, this is not an attractive position for any owner to be in, having already probably spent large sums stacking the unit, as well as incurring significant costs to bring the unit out of stacking.

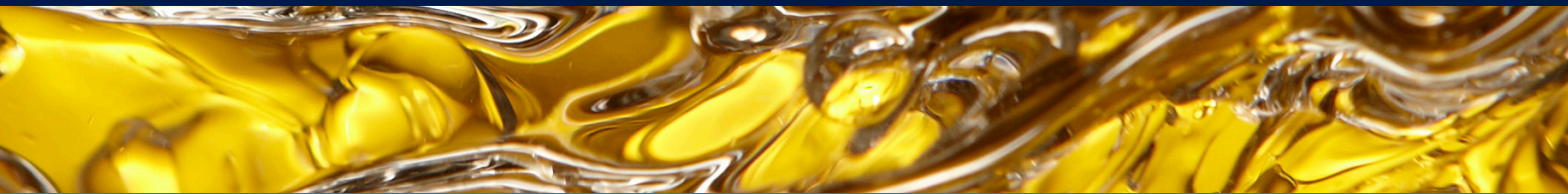
In our view

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Managing these uncertainties today

The process of stacking is not a new trend; drilling contractors for example have been warm stacking their rigs for decades. Rather, it is the extended duration of the stacking it today's market which is causing the charterer to mitigate the risk of the any failures in the reliability or functionality of a unit.

The consequences of this are far-reaching. Whatever the unit 'type' may be, there are a host of demanding



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and interrelated key systems which will require to be kept up to date and relevant to the market demands at the time. Certain aspects are common to most units, from the engines and switchboards that provide power to various systems that provide marine capability, be it jack up legs, anchor spreads or DP propulsion systems. But there are also systems specific to the purpose of the unit. For example, on an offshore diving support vessel, it is the isolation chambers and diving bells. On a pipe laying barge, it is the pipe carousel and tensioner installed on the deck. On drilling rigs, it is the drilling systems that run from the crown block to the drill bit. The list is endless.

In our view

In maintaining and testing these systems, Class can assist, but only to a limited extent. There is no 'one size fits all' contractor who can service the highly specialised systems utilised in different segments of the offshore industry. The supply chain is therefore required to be proactive now.

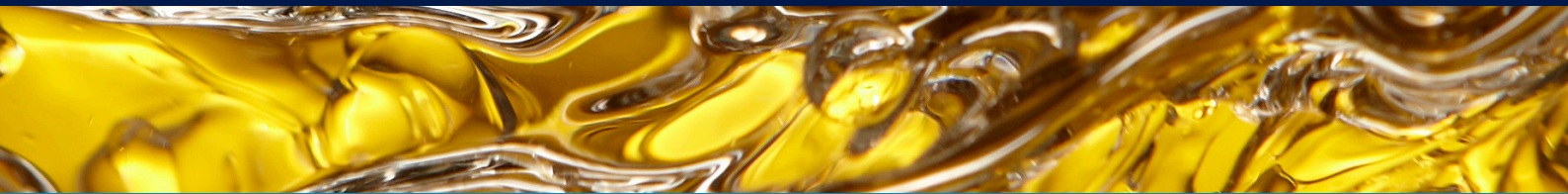
Disputes: action and re-action

It is the shipyards, fabricators, original equipment manufacturers and such similar contractors who are the obvious parties that can ensure that a unit remains relevant whatever the month or year, across the various systems identified above. While the need for renewal and upgrading works may not be obvious now, it will be in the near future.

It is foreseeable that a new type of contracting relationship between owners and shipyards, manufacturers and contractors will develop significantly over the next few years as the market begins to improve. Many forward-looking equipment manufacturers have fortunately begun developing 'life of facility' relationships with rig owners, similar to the 'life of field' programs that have recently been promoted by some of the integrated energy service companies.

Contentious terminations and suspensions is a common theme in

our experience in offshore construction at the moment, as parties struggle to come to terms with a market that hovers between US\$50 and US\$60 per barrel. However owners are advised to be mindful of the contractual and operational challenges they are yet to face following the stacking of their current fleet. By engaging in protracted and acrimonious disputes with shipyards, fabricators or original equipment manufacturers, owners may find it difficult to procure these same service providers in the future as they will be required to maximise an owner's chances of securing a charter for its unit.



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