

Offshore
Energy

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OFFSHORE ENERGY BULLETIN



Welcome to the first edition of our new Offshore Energy Bulletin.

In this edition, we cover a broad spectrum of issues affecting the offshore industry. The lead article highlights increasing piracy in the Gulf of Guinea with offshore installations and support vessels regularly targeted. We follow with an article which focuses on helicopters and a reminder of the unique features of rotor wing support in the offshore industry. Continuing with the theme of issues unique to offshore, we follow with an article on FPSO's and whether they are "ships".

Consultation on the WELCAR 2011 wording continues and we highlight some of the key issues. We are also reminded of financial challenges and the resourcefulness of the industry to use ECA-backed bonds to allow much needed investment. Finally, we consider the consultation draft of WINDTIME 2011.

Should you require any further information or assistance on any of the issues dealt with here, please do not hesitate to contact any of the contributors to this Bulletin or your usual contact at HFW.

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Piracy in the Gulf of Guinea - practical and commercial considerations

Piracy off the coast of Somalia has dominated media coverage of piracy in recent years. The good news is that piracy incidents are at a five year low (297 ships in 2012 compared to 439 in 2011). Somali piracy, in particular, has reduced significantly (75 attacks in 2012 compared with 237 in 2011). These reductions are due to a combination of factors. Privately contracted armed guards have proven to be an effective deterrent to pirates. So too are the navies that now patrol this area, particularly their focus in early 2012 on targeting motherships.

Piracy in the Gulf of Guinea, however, is on the increase (58 piracy incidents in 2012) and offshore installations and support vessels are increasingly the targets of these pirates. There have been numerous, almost daily, attacks this year, many resulting in the kidnap of crew members and, in the case of the "PYXIS DELTA", the death of a crew member.

The nature of the threat posed by West African pirates is quite different to that posed by Somali pirates. Whereas Somali pirates are interested in hijacking a vessel, sailing it to a safe haven on the Somali coast and extorting a ransom in return for the release of the ship, cargo and crew, pirates in the Gulf of Guinea have no such safe havens. Unlike Somalia, West African governments have a sufficient law enforcement deterrent to prevent ships being held within their jurisdictions for extended periods. West African pirates are thus concerned with kidnapping the crew or stealing the cargo as quickly as

possible before it is ultimately located by the authorities. Vessels hijacked in the Gulf of Guinea are rarely held for more than eight days. Recognising this threat, international shipping associations have developed the New Interim Anti-Piracy Guidelines for the Gulf of Guinea available here: https://www.bimco.org/Home/News/2012/12/20_New_Interim_Anti-piracy_Guidelines_for_Gulf_of_Guinea.aspx.

Offshore operators are particularly vulnerable to pirate attacks:

- Tankers carrying petroleum products to and from offshore installations are easier to board while they wait for loading/ discharging operations.
- The ease with which such products can be discharged into awaiting vessels by means of STS transfer means a successful cargo theft can be over within hours.
- The ready availability of a black market for petroleum products in the Gulf of Guinea makes vessels loaded with such cargo attractive.
- Offshore supply vessels with their comparatively low freeboards also make for relatively softer targets.

Some argue that the situation is not helped by the policy of the littoral states to prohibit the use of third party armed guards on board ships. This role is instead entrusted to their respective navies which would be sufficient were it not for the limited capabilities of those navies. Angola, for example, has insufficient vessels

in its navy to patrol what is one of the longest coastlines in West Africa.

The increase in the number of piracy incidents has led to an increase in calls for states in the Gulf of Guinea to allow the use of foreign armed guards within their waters and the issue is being debated by legislators in Nigeria and other West African states. However, high levels of corruption in this region have prompted some to argue that the use of armed guards could worsen the situation.

The first priority in the case of any pirate attack must, of course, be the safety of the crew, as well as that of the cargo and the vessel. However, the release of crew, cargo and/or vessel is, unfortunately, not the end of the issues that arise following hijacks. Commercial and legal considerations also arise:

- Are ransom payments legal?
- Are they recoverable in General Average?
- Is a hijacked ship off hire?

These are just a few of the issues that can arise following successful hijackings. Other issues will invariably arise out of the various charterparty and bill of lading terms and conditions as well as the insurance contracts held by the stakeholders.

Regrettably, the scourge of piracy is likely to threaten commercial operations in the Gulf of Guinea for some time to come. Operators in this area are advised to, carefully, consider practical, legal and commercial measures to ensure that the risk to human life and property is



minimised/averted and to ensure that their legal/commercial positions are protected to the extent possible.

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Aviation issues in the offshore energy sector

The controlled landing of a CHC Eurocopter EC225 helicopter that occurred approximately 23nm south west of Sumburgh, Shetland Islands on 22 October 2012, again puts the focus on rotor wing support operations for the offshore energy sector.

The incident did not cause any casualties and no physical injuries to flight occupants were reported to the operator at the time. The flotation devices aboard the helicopter both enabled the safe evacuation of the flight occupants and allowed for the recovery of the helicopter by a vessel chartered for the purpose.

Whenever such an event occurs, it is subject to comprehensive technical investigation according to procedures derived from international conventions and given effect under EU regulations and statute law in the UK. The Air Accidents Investigation Branch (AAIB) has powers to compel evidence and take charge of the helicopter. They have already published special bulletins and a full report will follow. This is a process designed to ensure the safety of operations and

airworthiness of the helicopter on a global basis.

Meanwhile, the EC225 type is affected by severe operating limitations effectively amounting in some cases to a grounding, with consequent disruption to operations. This has led to some relaxation of legal provisions to allow for use of vessels to transport persons to offshore installations.

The event concerning the CHC helicopter is unusual in that the precipitating technical cause appears to be almost the same if not identical to that affecting a Bond Helicopter EC225 only five months beforehand. Obviously the investigation techniques are designed to prevent any reoccurrence of a given cause. The technical investigation of the two incidents has now been co-joined by the AAIB. The origin appears to rest in the airworthiness of the main gearbox. Although the EC225 type involved in the incidents appeared to include a technical defect in the gearbox triggering the operation of an emergency system, it was perverse that in each case the pilots were required to execute a controlled landing when given a false warning of a failure.

Whenever an event occurs involving aviation in offshore energy support, there may be compensation issues. The rules applicable to the relationship as between the helicopter operator and the passengers are those derived from aviation law. Other aspects will be regulated by the terms of the contract between the operator and its customers.

Nevertheless, and notwithstanding other technical issues, the improving safety record for such rotor wing

operations globally is testament to the very considerable investment made by both the offshore energy sector and the helicopter industry in developing offshore performance standards, safety management systems, flight data monitoring and an ever-enhancing safety culture to ensure safety and in extremis survivability in offshore events.

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FPSOs - recent developments in classification and regulation

The question of whether FPSOs, FSOs, and other floating offshore units may be defined as “ships”, and therefore governed by laws and regulations that apply to “ships”, has long vexed the offshore energy industry.

The consequences of the question being decided one way or another are potentially very significant. For example, the main international maritime conventions that permit limitation of liability apply to the owners of – and sometimes to other parties with an interest in – a “ship”. If an FPSO falls within that definition, its owners may be entitled to limit their liability in the event of, say, a catastrophic pollution incident. Limitation would not, however, be available if an FPSO is not a “ship”.

Every major participant in an FPSO project - the unit's owners, charterers, operators, financiers, and their respective insurers - will want to know whether or not limitation will be available. The financial ramifications



cannot be overstated. Taking as an example a typical VLCC-sized tanker, the current limit of liability in the UK for physical damage claims would be about US\$135 million for oil pollution, and about US\$65 million for other maritime incidents. The scale of recent offshore accidents demonstrates that these sums are substantially lower than the liabilities that can be faced in the wake of a serious incident. The tragic events in the Gulf of Mexico three years ago are a case in point.

HFW have issued a detailed briefing on these issues, which was later published by the International Oil & Gas Journal, and is available here: <http://www.hfw.com/Legal-and-regulatory-treatment-oil-gas-Sept-2012>

There have since been a number of important international developments concerning the definition of “ship” and the classification of FPSOs.

In November 2012, the Federal Court in Rio de Janeiro decided that certain floating units, including FPSOs, were not “vessels” for the purpose of Brazilian income tax legislation. As a consequence of this decision, Petrobras may incur additional tax liabilities of nearly US\$5 billion in respect of charter hire payments for such units. It is understood that this decision is now under appeal by Petrobras.

More recently, in January 2013 the Supreme Court, the highest court in the United States, decided that a floating residence moored at a Florida marina was not a “vessel” under federal maritime law. As a result, local authorities were not entitled to arrest the unit to recover unpaid docking fees. Although this may seem a

world away from floating production units servicing the offshore oil and gas industry, the Supreme Court’s reasoning as to the true meaning of “vessel” will undoubtedly have consequences far beyond Palm Beach. In fact, the decision has already been followed in another US case concerning the sinking of one of the world’s largest floating drydocks.

Finally, the International Maritime Organisation (IMO) is presently reviewing the application of its technical standards to “offshore industry vessels”. A key part of this review is to establish a clear and workable classification of such vessels, and proposals have been made for a defined category of “Mobile Offshore Units”, as distinct from other special purpose ships. The IMO is set to deliberate these issues at its 57th Ship Design and Equipment Session, in March 2013.

These recent developments demonstrate that the question of whether or not FPSOs are “ships” is a controversial one in many different jurisdictions, and in many different contexts – including taxation, admiralty/arrest, technical standards, safety, and limitation of liability. The controversy is unlikely to be resolved soon, and all participants in offshore floating projects should be mindful of these complex issues and their potentially serious financial implications.

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WELCAR 2011 update

The WELCAR 2011 wording was due to be published in January 2012, but this was delayed pending a second consultation phase. The stated aim of the new wording is to reflect ten years of underwriting experience on the basis of WELCAR 2001 and to improve the quality of the wording by bringing greater clarity and consistency through the use of more contemporary language. In August 2012 we issued an article (please see the link <http://www.hfw.com/Revision-to-offshore-construction-policy-Aug-12>) commenting on some key proposed changes to the 2001 wording along with commentary on reactions from insureds and contractors. So 18 months on from publication, where do matters stand now?

There is little for us to add to our commentary on the key proposed changes and the reactions discussed in our previous article, as these still stand, and formal publication of the WELCAR 2011 wording is still eagerly awaited. However, issues as to Defective Part and the Damage to Existing Property buy-back are particular areas which need clarification, and uncertainty as to coverage on these issues continues to cause contention.

Defective Part

Whilst “Defective Part” is defined in WELCAR 2001, “part” is not, and “Defective Part” is defined by reference to “part.” This gives rise to a rather circular situation, since it is difficult to determine exactly what “Defective Part” means. Broadly speaking, coverage is provided under WELCAR 2001 for damage caused by a “Defective Part.” However, cover is restricted regarding the “Defective



Part” itself. Identifying the “part” in question is frequently the subject of claims. There have been increasing efforts to define the meaning of “part.” However, the position remains unclear. In the Court of Appeal case, *The Nukila Promet Engineering (Singapore) Pte Ltd v Sturge* [1997] 2 Lloyd’s Rep. 146, Hobhouse LJ came up with the “obviousness” test, and commented that a defective weld could be just as much a “part” as a bulk head or plate or the totality of a leg structure. However, this is somewhat circular, since it is arguable that the “totality of a leg structure” includes the welds. Ultimately the facts of that case did not require the court to rule on the point and there is little other case law which provides guidance. It was expected by many that the new WELCAR 2011 wording would include a definition of “part” and resolve this issue once and for all. However, the wordings that have been seen so far have not attempted to deal with this point, and we await to see if this changes in the new wording once published after the latest consultation phase.

“The circularity of the cross indemnity provisions contained in the contractual nexus of offshore construction programmes, often calls for the insured to supplement cover under Section II with the Damage to Existing Property buy-back, to add cover for damage to the insured’s existing property suffered under the protection of the knock-for-knock provisions.”

Damage to Existing Property

The circularity of the cross indemnity provisions contained in the contractual nexus of offshore construction programmes, often calls for the insured to supplement cover under Section II with the Damage to Existing Property buy-back, to add cover for damage to the insured’s existing property suffered under the protection of the knock-for-knock provisions. This effectively gives rise to first party claims being made under the buy-back. However, arguments have been raised by insurers that the fact the buy-back sits within the liability Section II of WELCAR 2001 should negate any such claims. Clarification on this in the new wording is expected.

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Offshore finance - an increased role for export credit agencies?

A myriad of articles proclaim the dearth of liquidity in the finance sector at large, and how “times are tough” across all markets. Finance professionals are all too familiar with the liquidity squeeze which the market is currently experiencing - as a result of the state of the global economy, issues with US Dollar availability, various sovereign debt crises and additional, expensive market regulation imposed by the Basel III regime.

While some markets are stagnating, there remains the will, and certainly the need, for deals to be forged in the offshore energy finance sector.

Other industries - in particular the aviation sector, and more recently, in the world of trade finance and commodities - are increasingly looking to alternative sources of finance which, while not necessarily new, have not been used as frequently in recent years.

One such route is through the involvement of the Export Credit Agency (ECA), and the issuance of ECA-backed bonds. Structurally, this involves the ECA issuing a bond, and applying the resulting funds towards the relevant project. This encourages investment, and hopefully opens-up liquidity, as it shifts the credit risk away from the asset sector/specific transaction, and on to the ECA itself. This also provides additional advantages through provision of a fixed interest rate, rather than the more standard floating rate traditionally associated with ECA loans.



In years gone by, ECAs have applied a narrow interpretation towards the types of projects they are prepared to become involved with. Traditionally, “national interest” (a guiding principle for the type of transaction which would be supported) leaned towards transactions which involved home-grown contracting parties. In recent times, however, a shift in interpretation has been seen. Under this approach, ECAs are displaying an increased appetite for transactions which have a positive effect on their national economy more generally, even where no home-grown contracting party is involved.

Several of our clients are increasingly involved with ECA-backed financings, an area in which HFW has particular expertise, and there is a feeling that their involvement will become more prevalent, with the use of the ECA-backed bond in particular, becoming more widely used. As the offshore energy sector seems to rebuff the downward trend in deal appetite, ECA bond support could provide a helpful means of realising funding for transactions in this sector.

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WINDTIME - Winds of change?

Since 2011, BIMCO has been developing a standard time charterparty for offshore wind farm support vessels that will be known as WINDTIME. Vessels currently providing these services tend to use amended SUPPLYTIME agreements.

A consultation draft of the WINDTIME form is currently in circulation. Subject to feedback, it is expected that WINDTIME will be put up for adoption by BIMCO’s Documentary Committee in May 2013 and, if approved, will be available for use shortly afterwards.

The basis for WINDTIME is the SUPPLYTIME 2005 form, although clauses not relevant to the offshore wind trade have been deleted and new operational clauses inserted. Two particular elements of SUPPLYTIME 2005 provided cause for concern.

Firstly, under SUPPLYTIME 2005 if owners miss the cancellation date and charterers elect to cancel the charterparty, the charterers have no recourse against owners for losses that might arise during the project

preparation phase (e.g. costs for standby machinery, equipment and personnel).

The draft WINDTIME form deals with the charterer’s right to cancel by listing three alternative options. The first prevents either party from claiming losses by reason of non-delivery of the vessel, and the second allows charterers to accept late delivery or cancel the charterparty. However, the third option is more unusual because it requires owners to pay liquidated damages at a set day rate, until owners deliver the vessel or a substitute vessel, or charterers elect to cancel the charterparty. The liquidated damages are capped at the maximum liability set out in the charterparty.

The second problem with using SUPPLYTIME 2005 for wind farm support vessels is the application of the knock-for-knock regime. These were viewed by many as inappropriate in the WINDTIME context, and several commentators had suggested they should be replaced by a traditional liability scheme, backed-up by suitable insurance arrangements.

The draft WINDTIME form does



contain knock-for-knock provisions. However, there is one significant difference to the SUPPLYTIME 2005 form. The draft WINDTIME form provides that where a member of owners' or charterers' group intentionally or recklessly commits an act that results in loss, damage, injury or death, the knock-for-knock provisions will not apply. These provisions will potentially enable parties to bring claims that could not have been brought under SUPPLYTIME 2005, and may thus result in more litigation.

It will be interesting to see whether either of these key provisions, or any others in the draft WINDTIME form, will be revised following the consultation period. Whatever the final outcome, the draft offers a bespoke contract designed to improve upon the generic terms and conditions currently used in the wind farm support vessel sector.

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Conferences & Events

Sea Asia

Singapore
(9-11 April 2013)
Presenting: Paul Aston

HFW Energy & Resources Seminar

HFW Perth
(10 April 2013)
Presenting: Hazel Brewer,
James Donoghue, Cheryl Edwardes,
and Julian Sher

2nd Annual Conference on Marine Salvage and Wreck Removal in India

Mumbai
(7 May 2013)
Presenting: Hugh Brown
Attending: Paul Dean and
Dominic Johnson

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