

Offshore

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OFFSHORE BULLETIN



Welcome to the February edition of our Offshore Bulletin.

With oil prices tumbling at an alarming rate and now at a 13-year low, it is not just the oil-producing companies that are affected, but all those working in the services industry. In this issue, we look at some of the main challenges faced by those operating in Africa and the Middle East, and discuss some of the steps operators can take to minimise the impact of the downturn on their businesses.

In addition to these market troubles, the owners, operators, charterers and insurers of FPSOs and other floating offshore units are also often faced with difficult legal and regulatory issues, in particular the extent to which they may be able to limit their liability for claims in respect of physical damage, personal injury or pollution. The latter issue may be one step closer to clarity, following recommendations made by an IOPC Working Group on whether FPSOs and other offshore units are 'ships' for the purposes of the CLC 1992. We summarise the main recommendations of the Working Group's final report.

Turning to contractual issues, although intended to avoid litigation between parties operating in an offshore field, knock-for-knock clauses are a complex area and often give rise to disputes. With the assistance of Tove Dickman Haugvaldstad of Advokatfirmaet Thommessen, we examine a recent case where the Norwegian court upheld an English law knock-for-knock clause.

Finally, BIMCO are in the process of updating their SUPPLYTIME 2005 charterparty. We examine some of the likely areas of focus, and discuss some possible improvements that could be made.

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.

[Paul Dean](mailto:paul.dean@hfw.com), Partner, paul.dean@hfw.com

[Emilie Bokor-Ingram](mailto:emilie.bokor-ingram@hfw.com), Associate, emilie.bokor-ingram@hfw.com



hfw Offshore challenges in the Middle East and Africa

In July 2014 Brent crude cost around US\$110 per barrel, a price around which it had fluctuated for about four years. Brent crude is currently hovering around the low US\$30s per barrel. Naturally the fortunes of the offshore support sector are closely tied to the price of oil, and the collapse of the oil price has had a significant impact on the industry.

The prospects for the offshore services industry generally remain bleak, as the oil price is unlikely to move upwards any time soon, and talk of any recovery and when that might happen is speculation. This has resulted in direct cuts in exploration and production (E&P) spend by a number of national and international oil companies and as a result, the fortunes of operators in the offshore services sector have been dramatically affected. The message from offshore operators around the world is consistent, namely pressure on rates leading to decreasing revenues and increased competition on new tenders, which are already few and far between.

On the demand side, global E&P spend is estimated to decrease again by up to 20% in 2016, according to www.reuters.com¹. The Middle East presents a different picture, where continued spending of local national oil companies such as Saudi Aramco and Abu Dhabi National Oil Co have bolstered the local market. An increase in E&P spending of 5% is expected in the region as these companies commit to ambitious five-year capital expenditure plans to raise production capacity, suggesting the Middle East



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TIEN TAI, PARTNER

may fare better than other global offshore centres.

On the supply side, over-supply and reduced demand has led to lower rates globally. We have seen evidence that oil companies are demanding a reduction on rates on existing charters and on options. Rates in the North Sea are at, or below, operating costs. In most cases rates in Southeast Asia, Brazil, the Gulf of Mexico and West Africa have fallen to levels last seen in the aftermath of the global financial crisis, and in many cases are now lower than they were in that period seven years ago.

Notwithstanding the local increased spend in E&P in the Middle East, most of the operators do not work exclusively on contracts with a local content. Accordingly, operators in the Middle East are very likely to be affected in the same way. We anticipate that the downturn in the offshore vessel market is likely to lead to a number of workouts and restructurings in 2016 as income falls and debt levels increase. These days, Middle East operators may be in varying stages of distress, ranging from a negative cashflow situation through

to an actual default, with a formal debt restructuring processes taking place.

For example, Polarcus, a Middle Eastern operator owning a fleet of seismic exploration vessels have, according to Lloyd's List, said in January 2016 that they are halting interest and amortisation payments while they seek debt restructuring with their creditors. Lloyd's List also reports that Rawabi Vallianz Offshore, incorporated in Saudi Arabia, is looking to refinance the bulk of its bank loans currently secured by its fleet of 20 vessels.

A number of operators in the Middle East have now published their financial results covering the first nine months with almost all reporting challenging economic conditions and pressure on rates. One client, Topaz Energy and Marine have, according to their website, recently redeployed four AHTs from Africa, where demand is weak, to the Middle East region to operate on a spot basis. In this respect, flexibility to move equipment and absorbing mobilisation costs are key.

One highlight to report in this depressed market is a US\$115 million

¹ <http://in.reuters.com/article/energyoutlook-research-barclays-idINKCN0UR0XO20160113>



new order in November 2015 by Topaz for two subsea construction vessels to be built by Vard. Deliveries are expected in the third and fourth quarters of 2017. The DP2 units will carry two remotely operated vehicles, according to a Topaz press release, underlining confidence in the long-term strength in the subsea sector. In addition, there are cost savings by committing to build in this market.

In other activity, the Offshore Support Journal Magazine reports that Abu Dhabi-based Gulf Marine Services, has ordered a construction vessel at a Chinese yard, Jiangsu Hongqiang. No price or other details have emerged except that delivery is planned for September 2017.

These are welcome orders, but it is too early to predict any sustained order revival and how much subsidy or other financial inducement may have been provided by the yards or the Export Credit Agreements (ECAs).

In summary, operators in the Middle East and globally need to adjust to the new benchmark of low oil prices and take active steps to reduce overhead costs to align with market realities and maximise fleet utilisation. We do not expect the market to improve materially during 2016 and all signs point to a continued challenging market backdrop. But even as the industry adapts to a lower oil price environment, operators will need to revise their operating and financial models to ensure they are delivering value and results in a challenging market.

For more information please contact **Tien Tai**, Partner, Dubai on +971 4 423 0578 or tien.tai@hfw.com, or your usual contact at HFW.

hfw Is an FPSO a ship? - Revisited

Should FPSOs and FSUs be treated as tankers and benefit from the same limitation provisions in CLC 1992 and Fund Convention 1992?

The 1992 Civil Liability Convention (CLC 1992) and Fund Convention 1992 provide for strict liability and compulsory insurance for shipowners in respect of oil pollution damage. In return, shipowners are entitled to limit their liability for pollution claims. Clearly, therefore, it is of some significance to owners and operators of floating offshore units whether the courts will treat these as ships, or in the same way as more permanent offshore installations. Opinion on the issue is divided, with countries like Japan (the largest contributor to the IOPC Fund, but with relatively few offshore E&P units) naturally wanting to restrict the scope of its application.

Since we last examined this question¹, an IOPC Funds Working Group has revisited the subject and has now published its final report², discussing the issues and making recommendations to the 1992 Fund Assembly in relation to the definition of a "ship" in the context of oil pollution liability.

Article 1 of CLC 1992 defines a 'ship' as "*any sea-going vessel and seaborne craft of any type whatsoever constructed or adapted for the carriage of oil in bulk as cargo, provided that a ship capable of carrying oil and other cargoes shall be regarded as a ship only when it is actually carrying oil in*

bulk as cargo and during any voyage following such carriage unless it is proved that it has no residues of such carriage of oil in bulk aboard."

The definition stipulates that the oil must be carried, but whether this covers FPSOs, FSOs and FSUs has always been a grey area³.

The Working Group has recommended a 'hybrid approach', combining:

- A non-exhaustive, illustrative list of vessel types clearly within or outside the definition of 'ship' under CLC 1992; and
- A case-by-case analysis by reference to the 'maritime transport chain'⁴ where it is not clear whether a vessel falls within or outside the definition.

The Working Group considered that offshore craft such as FDPSONs, FPSOs and FSUs (whether purpose-built or converted) with independent motive power would fall within the definition of 'ship' under CLC 1992 when carrying oil (or oil residues) and undertaking a voyage, whether under their own propulsion or being towed. On the other hand, vessels not designed for the carriage of oil, such as container ships, passenger vessels or dredgers, would fall outside the definition, as would drilling rigs, drill-ships and FPSOs when involved in exploration, production and/or processing.

In cases where it is not clear whether a structure is a 'ship' or not, the question should be decided on a case-by-case basis using the 'maritime transport chain' test. Where oil is produced offshore, the maritime transport chain

1 <http://www.hfw.com/Offshore-Bulletin-March-2015>

2 Seventh Intersessional Working Group of the IOPC Funds

3 The IOPC Fund Second Intersessional Working Group's Report published on 26 July 1999 concluded that the 1992 Conventions only covered vessels carrying oil as cargo 'on a voyage', so that offshore craft leaving a field for operational reasons or to avoid bad weather would not fall within the definition of a 'ship'.

4 This test was originally proposed by the Spanish delegation and later refined by the Australian delegation.



The proposed analysis certainly makes the position somewhat clearer, although many cases would still have to be decided on their specific facts.

EMILIE BOKOR-INGRAM, ASSOCIATE

begins when the oil “is loaded into a vessel other than the one that received the oil directly from the subsea well to which it was connected.” Any seagoing vessel or craft – tanker, FPSO, jack-up rig, mobile offshore production unit or other craft – will be a ‘ship’ from the moment it departs on a voyage laden with oil or, if it has its own independent motive power, from the moment the oil is loaded. The maritime transport chain ends when the oil is discharged. If it is transferred to another ship, this would amount to a new maritime transport chain.

It remains to be seen whether the 1992 Fund Assembly will adopt the Working Group’s recommendations. The proposed analysis certainly makes the position somewhat clearer, although many cases would still have to be decided on their specific facts.

For more information please contact [Emilie Bokor-Ingram](#), Associate, London on +44 (0)20 7264 8463 or emilie.bokor-ingram@hfw.com, or your usual contact at HFW.

hfw Knock-for-knock clauses considered in Norway

As readers will be aware, under English law knock-for-knock provisions ordinarily ensure that each party bears the risk of damage or injury to its own equipment, personnel and property – your property, your people, your problem. If liability from an incident is misdirected, then each party agrees to indemnify the others in order that the division of liability remains in accordance with the contract. Further, it is normally agreed that the knock-for-knock principle applies regardless of fault and/or negligence.

However, in the Norwegian Court of Appeal case *Njord B*¹ the court found that one party was not entitled to rely on the indemnity provision in the knock-for-knock provision because, under Norwegian law, liability in tort (*delicite*) exists alongside, or in addition to the contractual liability. Hence as one party was found to be grossly negligent, they could not rely on the knock-for-knock provisions to avoid liability.

This judgment thereby upset the widely held view of the offshore industry that the knock-for-knock provisions applied whether there was gross negligence or not.

But in 2015 a case came before the Sunnhordland District Court² where the knock-for-knock provisions were revisited as a result of a tow (a floating drydock) being lost.

The claimant drydock interests had petitioned for the arrest of a vessel

1 (LG-2012-77280)

2 *Princess Management Ltd v Zedare Shiptrading Corp and Lampros Chuntas* 15-122464TVI-SUHO

belonging to the defendant owners of the tug when it had called at Norway. Importantly, the parties had no links to Norway and the loss did not occur in Norway.

Both parties agreed that under the towage contract, governed by English law, it was not possible to bring a claim because of the knock-for-knock provisions. Based on *Njord B*, the claimant argued that the knock-for-knock clause did not apply because the defendant had acted with gross negligence, or acted wilfully, by neglecting to follow instructions that the tow could not be carried out if the wind force was greater than five on the Beaufort scale.

The defendants countered that:

- There was no ground for enforcement.
- The defendants had not tried to evade or considerably impede the claim
- The claimants had not shown that there was a probable basis for the claim as they had agreed that no liability could be made under the towage contract and no evidence was made regarding the possibility of *delicite* liability under English law.

Alternatively, the defendants argued that instructions had not been given concerning the wind force and that, even if they had, the defendants had not breached them.

The judge concluded that there was no ground for enforcement and, while acknowledging the possibility of tortious liability alongside or in addition to contractual liability, found that no such liability arose in this case, as the towage contract was governed by English law. No evidence had been provided that a similar tortious liability exists in English contract law, the law of the sea, or international maritime



On the face of it this decision is helpful for the offshore industry as it returns knock-for-knock to the widely understood position of each party bearing their own risks.

EDWARD WAITE, ASSOCIATE

law. Based on a strict interpretation of the wording of the towage contract, the petition for arrest was therefore rejected.

On the face of it this decision is helpful for the offshore industry as it returns knock-for-knock to the widely understood position of each party bearing their own risks. However, it is important to note that there was no direct link to Norway. Had the loss occurred in Norwegian waters, or the parties or governing law been Norwegian, then there may have been a different result.

For more information, please contact **Edward Waite**, Associate, London on +44 (0)20 7264 8266 or edward.waite@hfw.com, or Tove Dickman Haugvaldstad, Senior Associate at Advokatfirmaet Thommessen, Oslo office, or your usual contact at HFW.

hfw New Supplytime Form

The most widely-used charterparty for offshore service and support vessels, Supplytime 2005, is over a decade old and is currently under review, with a new version expected to be published by BIMCO in early 2017.

The drafting committee, with industry input, is in the process of identifying key areas for revision. Supplytime 2005 is generally perceived as owner-friendly, and it has increasingly been felt that it could be more balanced. In addition, some provisions are insufficiently clear, or not in line with the current position under English law. Nevertheless, Supplytime 2005 is very popular and, according to BIMCO, the revision *“is likely to be in the form of a “light touch”, focusing on incorporating the latest editions of BIMCO standard clauses such as Dispute Resolution and CONWARTIME.”*

We examine some of the likely key provisions, and discuss some improvements that could be made to Supplytime 2005.

Knock-for-knock (Clause 14 – Liabilities and Indemnities)

Supplytime 2005 broadened the definitions of ‘Owners’ Group’ and ‘Charterers’ Group’. However, depending on the contractual arrangements, sometimes the definitions are not broad enough. Owners may need to amend ‘Charterers’ Group” along the following lines:

- Both ‘contractors and sub-contractors’ and ‘customers’ (in clause 14(a) and 14(e)) should be followed by the words ‘of any tier’ to cover the increasingly complex contractual arrangements in offshore operations.
- Charterers’ customer’s co-venturers should also be included, as they

will typically own a share of the field and the offshore units - this is a cause of disputes we often see.

It can also assist the parties to insert the words ‘or non-performance’ in lines 634 and 658, so that owners and charterers are protected under the knock-for-knock for the events and losses named arising from a total failure by a member of their respective ‘Groups’ to perform the charterparty, as well as for events and losses arising from actual performance.

In the case of Owners’ Group, without this amendment, it is likely that a ‘radical breach’ of the charterparty – such as deliberate non-performance – could fall outside the knock-for-knock regime¹.

The Windtime form² incorporates this amendment (for both parties’ benefit) and we expect it will be included in the revised version of Supplytime.

Another common amendment is the express inclusion or exclusion of gross negligence. Whilst this is not a separate concept under English law, parties often wish to refer to it expressly. Some charterers, especially major oil companies, frequently require it to be excluded from the knock-for-knock regime. Windtime expressly includes gross neglect, but excludes wilful misconduct, and it will be interesting to see if Supplytime follows suit.

Consequential Damages (Clause 14(c))

The word ‘consequential’ in this context has a very specific meaning under English law, covering only losses

¹ *A Turtle Offshore SA v Superior Trading Inc (The “A Turtle”)* (2009) 1 Lloyd’s Rep 177

² The wind-industry-specific time charter party for crew transfer and other service vessels, based on Supplytime 2005, sample copy available at https://www.bimco.org/Chartering/Clauses_and_Documents/Documents/Offshore_Towing_and_Heavylift/WINDTIME.aspx



which were unforeseeable in the absence of specific information. Clause 14(c) may therefore not be effective in excluding loss of production, loss of profits and so on, which follow in the normal course of things from a breach of contract. This issue has been addressed in *Windtime*³, and we would expect the new *Supplytime* to adopt a similar approach.

Early Termination For Cause (Clause 31(b))

Clause 31(b) could benefit from clarification in several respects, in relation both to the events that may entitle a party to terminate, and the procedure for doing so. The *Windtime* wording makes it clear that if a party is in repudiatory breach, the grace period and notification provisions in clause 31(b) do not apply and the innocent party may terminate immediately⁴. However, there is room for further clarification. A party becoming aware of one of the circumstances described in clause 31(b)(i) to (vi) must currently notify the other party of the occurrence *'and its intention to terminate'*, but it is unclear what that party must do if it does not intend to terminate. Conversely, it seems that after the three-day grace period, a party may terminate based on information notified by the other party – without itself having to give any warning or grace period before terminating.

3 Clause 16(b) of *Windtime*

4 Clause 31(c) of *Windtime*. This reflects the position at common law.

Conclusion

Windtime has clarified several areas, and has been well-received in the market, despite placing increased potential liabilities on owners. However, *Windtime* is a charter for very specific purposes, and less frequently used than *Supplytime*. It remains to be seen to what extent its improvements, and shortcomings, will appear in the new *Supplytime*.

One possible useful addition not expressly mentioned by BIMCO in their recent statements about *Supplytime* is BIMCO's new Anti-Corruption Clause, published in November 2015 – although some major oil companies may no doubt prefer to continue using their own bespoke provisions.

Some may say *"if it isn't broken, don't fix it"*, but BIMCO consider that the time is right to provide an updated form. It will be interesting to see how the drafting committee manages to balance the industry feedback received, and the need for legal improvement and clarification, against due consideration of the popularity of the 2005 edition.

For more information please contact [Scott Pilkington](#), Senior Associate, Singapore on +65 6411 5357 or scott.pilkington@hfw.com, [Emilie Bokor-Ingram](#), Associate, London on +44 (0)20 7264 8463 or emilie.bokor-ingram@hfw.com, or your usual contact at HFW.

Conferences and events

India Maritime Summit 2016- Emerging Opportunities In Indian Shipping & Port Sector

Mumbai
12 February 2016
HFW are sponsoring this event.
Presenting: Paul Dean
Attending: David Morriss

Decommissioning & Abandonment Summit

Houston
23 – 25 February 2016
HFW are sponsoring this event.
Presenting: Paul Dean

HFW Offshore seminar: Getting Paid: Dealing with Insolvency and Payment Risks

Singapore
25 February 2016
Presenting: Chanaka Kumarasinghe, Suzanne Meiklejohn and Adam Richardson

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