

Global Arbitration Review

# The Guide to Energy Arbitrations

---

General Editor  
J William Rowley QC

Editors  
Doak Bishop and Gordon Kaiser

Third Edition

# The Guide to Energy Arbitrations

Third Edition

General Editor

J William Rowley QC

Editors

Doak Bishop and Gordon E Kaiser

Reproduced with permission from Law Business Research Ltd

This article was first published in January 2019

For further information please contact [Natalie.Clarke@lbresearch.com](mailto:Natalie.Clarke@lbresearch.com)



**Publisher**

David Samuels

**Business Development Manager**

Gemma Chalk

**Editorial Coordinator**

Hannah Higgins

**Head of Production**

Adam Myers

**Copy-editor**

Rakesh Rajani

Published in the United Kingdom  
by Law Business Research Ltd, London  
87 Lancaster Road, London, W11 1QQ, UK  
© 2018 Law Business Research Ltd  
[www.globalarbitrationreview.com](http://www.globalarbitrationreview.com)

No photocopying: copyright licences do not apply.

The information provided in this publication is general and may not apply in a specific situation, nor does it necessarily represent the views of authors' firms or their clients. Legal advice should always be sought before taking any legal action based on the information provided. The publishers accept no responsibility for any acts or omissions contained herein. Although the information provided is accurate as of November 2018, be advised that this is a developing area.

Enquiries concerning reproduction should be sent to Law Business Research, at the address above. Enquiries concerning editorial content should be directed to the Publisher – [David.Samuels@lbresearch.com](mailto:David.Samuels@lbresearch.com)

ISBN 978-1-78915-099-5

Printed in Great Britain by  
Encompass Print Solutions, Derbyshire  
Tel: 0844 2480 112

# Acknowledgements

The publisher acknowledges and thanks the following firms for their learned assistance throughout the preparation of this book:

20 ESSEX STREET

ALLEN & OVERY LLP

BAKER McKENZIE LLP

BENNETT JONES LLP

BENNETT JONES (GULF) LLP

DEBEVOISE & PLIMPTON LLP

DOUG JONES AO

EDISON SPA

FRESHFIELDS BRUCKHAUS DERINGER US LLP

FTI CONSULTING

GIBSON, DUNN & CRUTCHER LLP

GORDON E KAISER (JAMS)

HAYNES AND BOONE CDG, LLP

HOWARD ROSEN

KING & SPALDING

ORRICK, HERRINGTON & SUTCLIFFE (UK) LLP

PAUL HASTINGS LLP

SQUIRE PATTON BOGGS

THREE CROWNS LLP

WILMER CUTLER PICKERING HALE AND DORR LLP

# Contents

Editor's Preface ..... vii  
*J William Rowley QC*

## Overview

The Breadth and Complexity of the International Energy Industry ..... 1  
*Doak Bishop, Eldy Quintanilla Roché and Sara McBrearty*

## Part I: Investor-State Disputes in the Energy Sector

1 Expropriation and Nationalisation ..... 17  
*Mark W Friedman, Dietmar W Prager and Ina C Popova*

2 The Energy Charter Treaty ..... 33  
*Cyrus Benson, Charline Yim and Victoria Orlowski*

3 Investment Disputes Involving the Renewable Energy Industry under  
the Energy Charter Treaty ..... 55  
*Charles A Patrizia, Joseph R Profaiizer, Samuel W Cooper and Igor V Timofeyev*

4 Of Taxes and Stabilisation ..... 68  
*Constantine Partasides QC and Lucy Martinez*

5 Utilities, Government Regulations and Energy Investment Arbitrations ..... 85  
*Nigel Blackaby*

6 The Role of Sovereign Wealth Funds and National Oil Companies in  
Investment Arbitrations ..... 96  
*Grant Hanessian*

**Part II: Commercial Disputes in the Energy Sector**

7 Construction Arbitrations Involving Energy Facilities: Power Plants, Offshore Platforms, LNG Terminals, Refineries and Pipelines .....113  
*Doug Jones AO*

8 Offshore Vessel Construction Disputes .....131  
*James Brown, William Cecil and Andreas Dracoulis*

9 Disputes Involving Regulated Utilities.....142  
*Gordon E Kaiser*

10 Arbitrations Involving Renewable Energy.....166  
*Gordon E Kaiser*

11 Upstream Oil and Gas Disputes .....188  
*Mark Beeley and Sarah Stockley*

**Part III: Contractual Terms**

12 The Evolution of Natural Gas Price Review Arbitrations.....199  
*Stephen P Anway and George M von Mehren*

13 Gas Price Review Arbitrations: Certain Distinctive Characteristics .....209  
*Mark Levy*

14 Destination Restrictions and Diversion Provisions in LNG Sale and Purchase Agreements .....218  
*Steven P Finizio*

15 The Review of Gas Prices with a Hub Indexation: An Unknown Territory .....232  
*Marco Lorefice*

**Part IV: Procedural Issues in Energy Arbitrations**

16 Consolidation of International Commercial Arbitral Proceedings in the Energy Sector.....243  
*George M Vlavianos and Vasilis F L Pappas*

17 Compensation in Energy Arbitration .....258  
*Samantha J Rowe, Aimee-Jane Lee, and Maxim Osadchiy*

18 Expert Evidence.....279  
*Matthias Cazier-Darmonis and Howard Rosen*

**Conclusion**

The Challenges Going Forward .....288  
*Gordon E Kaiser*

About the Authors .....295

Contributing Law Firms' Contact Details.....311

## **Editor's Preface to the Third Edition**

Economic liberalisation and technological change over the past several decades have altered the global economy profoundly. Businesses, and particularly those involved in the energy sector, have responded to reduced trade barriers and advancement of technology through international expansion, cross-border investments, partnerships and joint ventures of every description.

The move to today's 'internationality' of business and trade patterns alone would have been sufficient to jet-propel the growth of international arbitration. But when coupled with the uncertainties and distrust of 'foreign' court systems and procedures, the stage was set for a move to processes and institutions more suited to the resolution of a new world of transborder disputes.

Not surprisingly, the concept and number of international commercial arbitrations have grown enormously over the past 25 years. Bolstered by the advantages of party autonomy (particularly over access to a neutral forum and the ability to choose expert arbitrators), confidentiality, relative speed and cost-effectiveness, as well as near worldwide enforceability of awards, the system is flourishing. And if a single industry sector can lay claim to parental responsibility for the present universality of international arbitration as the go-to choice for the resolution of commercial and investor-state disputes, it must be the energy business. It is the poster boy of arbitral globalisation.

Led by oil and gas, the energy sector is marked by enormously complex, capital-intensive international deals and projects, frequently involving prominent parties and state interests. Transactions and partnerships are often long-term in nature, and involve 'foreign' places and players. Political instability and different cultural backgrounds characterise many of the sector's investments. In short, the energy sector is a natural incubator for disputes best suited to resolution through international arbitrations.

Indeed, over the past 50 years or so, following a rash of nationalisations in North Africa, the Gulf States and in parts of Latin America, and the lessons learned in 'foreign courts', there is scarcely a major energy sector contract (whether oil, gas, electric, nuclear, wind or

solar) that does not call for disputes to be resolved before an independent and neutral arbitral tribunal, seated, where possible, in a neutral, arbitration-friendly place.

The experience and statistics of the major arbitral institutions bear out the claim that the energy sector has driven, and continues to account for, major growth in international arbitration. ICSID is illustrative, where 42 per cent of its caseload in 2017 involved the energy sector. At the LCIA, case statistics for 2017 revealed that some 34 per cent of respondents were from the energy and resources sector. Between 2014 and 2015, the Stockholm Chamber of Commerce Arbitration Institute saw a 100 per cent increase in the number of its energy-related cases.

Although much of the evidence of the energy sector's arbitral demand is anecdotal, those arbitrators who are known in the field report growing demand and a steady increase in enquiries as to availability. And having regard to the multifaceted fallout from the oil price crash of 2014, a revival of resource nationalism (which exacerbates the natural tension between energy investors and host states), together with Russia's continuing economic difficulties and a world where sanctions imperil contractual performance, the only realistic expectation is for further reliance on arbitrators and arbitral institutions to cope with the disputes that are surfacing daily.

Another driver towards arbitration is the fact that the number of substantive players in the sector is relatively limited. These parties will invariably have multiple agreements, partnerships and joint ventures with each other at the same time, many of which are long term. These dynamics call for disputes to be resolved by decision makers who are known to and trusted by all, and whose decisions are final. The simple fact about business is that the economic uncertainty associated with an unresolved dispute overhanging a long-term partnership is often considered to be more problematic than getting to its quick and definitive resolution, even if the resolution is unfavourable in the context of the particular deal.

Against this backdrop, when Gordon Kaiser raised the question with me in the summer of 2014 of producing a book that gathered together the thinking and recent experiences of some of the leading counsel in the sector, it resonated immediately. Gordon was also more than pleased when I suggested that we might try to interest Doak Bishop as a partner in the project.

With Doak's acceptance of the challenge, we have tried, in the first two editions, to produce a coherent and comprehensive coverage of many of the most obvious, recurring or new issues that are now faced by those who do business in the energy sector and by their legal and expert advisers.

Before agreeing to take on the role of general editor and devoting serious time to the project, we needed to find a publisher. Because of my long-standing relationship with Law Business Research, the publisher of *Global Arbitration Review*, we decided that I should discuss the concept and structure of our proposed work with David Samuels, GAR's publisher, and Richard Davey, then managing director of LBR. To our delight, the shared view was that the work could prove to be a valuable addition to the resource material now available. On the assumption that we could persuade a sufficient number of those we had provisionally identified as potential contributors, the project was under way.

Having taken on the task, my aim as general editor has been to achieve a substantive quality consistent with *The Guide to Energy Arbitrations* being seen as an essential desktop reference work in our field. To ensure the high quality of the content, I agreed to go

forward only if we could attract as contributors colleagues who were among the internationally recognised leaders in the field. The book is now in its third edition, and Doak, Gordon and I feel blessed to have been able to enlist the support of such an extraordinarily capable list of contributors over the years.

The third edition of *The Guide to Energy Arbitrations* has been expanded with a new chapter on upstream oil and gas disputes. The remaining chapters have all been updated to reflect developments since 2017.

In future editions, we hope to fill in important omissions, such as the changing dynamics of investment cases under the Energy Charter Treaty, including the consequences of the *Achmea* decision of the European Court of Justice; the contours of fair and equitable treatment; injunctions against and the setting aside of awards; bribery and corruption; sovereign immunity and enforcement issues; *force majeure* and contractual allocations; and intellectual property and insurance disputes in the energy sector.

Without the tireless efforts of the GAR/LBR team this work never would have been completed within the very tight schedule we allowed ourselves. David Samuels and I are greatly indebted to them. Finally, I am enormously grateful to Doris Hutton Smith (my long-suffering PA), who has managed endless correspondence with our contributors with skill, grace and patience.

I hope that all of my friends and colleagues who have helped with this project have saved us from error – but it is I alone who should be charged with the responsibility for such errors as may appear.

Although it should go without saying, this third edition will obviously benefit from the thoughts and suggestions of our readers, for which we will be extremely grateful, on how we might be able to improve the next edition.

**J William Rowley QC**

September 2018

London

# Part II

---

## Commercial Disputes in the Energy Sector

# 8

## Offshore Vessel Construction Disputes

**James Brown, William Cecil and Andreas Dracoulis<sup>1</sup>**

It was not until the late 1970s that deep-water offshore oil and gas exploration became significantly viable. The driver was the ever-increasing demand for oil and gas products, which provided the opportunity to raise the capital necessary to design and then build the incredibly complex floating assets needed to explore for, and then produce, oil and gas in such hostile environments.

Today, it is not unusual for oil and gas drilling and production to be undertaken in depths in excess of 10,000 feet of water. The units that undertake such work are incredibly complex feats of engineering and may take up to three years to construct. Certainly at the peak of the market, the most complex and technologically advanced units cost in excess of US\$1 billion to construct.

The offshore oil and gas industry today, however, requires more than merely the deployment of drilling units for its operation. The industry now requires a full range of vessels to support it, including FPSOs (floating production storage offloading), FSUs (floating storage units), accommodation vessels (floatels), heavy-lift vessels, pipe-laying vessels and myriad support vessels.

Perhaps unsurprisingly, it is the largest and most sophisticated commercial shipbuilding yards that have moved into the construction of offshore oil and gas floating units. Incentivised by the potentially lucrative nature of building such assets, in recent years it has tended to be the shipyards of South Korea, China and Singapore that have been the pre-eminent builders.

Being a development from commercial shipbuilding, the projects tend to be undertaken on similar contractual terms and to incorporate aspects of both construction and sale of goods contracts.

---

<sup>1</sup> James Brown, William Cecil and Andreas Dracoulis are partners at Haynes and Boone CDG, LLP.

Currently the market for the construction of such units is significantly depressed. The sudden and sustained crash in the oil price that began from mid-2014, which caused oil to fall from well over US\$100 per barrel to a low of around US\$30 per barrel, significantly impacted the appetite for the construction of such units pursuant to newbuilding contracts. Although the oil price is today back at around US\$75 per barrel at the time of writing, there has not as yet been any significant and sustained pickup in newbuilding orders, primarily because there remains an oversupply of available rigs in the market relative to demand for them.

Recent years have continued to be characterised by a wave of disputes arising in respect of ongoing projects for the construction of such vessels (typically, in respect of orders placed before the oil price collapse for units nearing their delivery date). As detailed below, the trend has been one of buyers seeking to exit their contracts lawfully because they expect significantly reduced cash-generating potential in light of the significant fall in day rates over recent years coupled with the chronic oversupply of offshore units in the market.

This chapter will provide an overview as to why arbitration is the typical method of dispute resolution related to newbuilding projects, and the types of disputes that commonly arise and how they are usually resolved, and it considers some common strategies for their successful resolution by arbitration.

While there are currently some glimmers of hope for the market, owing to increases in the price of oil, currently resulting from factors including the Trump administration's decision to re-impose sanctions on Iran and efforts by OPEC to seek to address the worldwide glut in the supply of oil to encourage price rises, expectations remain tempered by the continued oversupply of drilling units. Demand will have to pick up significantly before there is a marked increase in newbuilding projects. Circumstances will change, however, and when they do arbitration will inevitably remain the tool chosen by most parties for the resolution of offshore unit construction disputes.

## **Why parties choose to arbitrate**

### **Ease of enforcement**

That disputes should be resolved by way of arbitration<sup>2</sup> is usually a simple choice for the parties.

With the builder and the buyer of the unit usually in separate countries, and agreeing for their disputes to be resolved in the forum of a neutral third country, the ease of enforcing a legal determination made in one country against the assets of the other party in another will be at the forefront of the parties' minds when negotiating their contract. Arbitration will therefore usually be the preferred method of dispute resolution, given the simplicity with which awards can be enforced between contracting states to the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (the New York Convention).

---

2 The contract may sometimes specify, however, for preliminary steps of alternative dispute resolution, for example, meetings of senior managers or mediation before arbitration.

## Confidentiality

A belief that arbitration provides for a confidential method of dispute resolution is usually a further important factor in the parties' decision to choose it as their method of dispute resolution. This is particularly relevant where the matters in dispute are commercially sensitive, which is often so in the context of offshore construction disputes.

As a matter of English law, an English court will uphold the implied duty on the parties to treat the arbitration as confidential, unless there are valid reasons not to, for example, because disclosure is in the interests of justice. However, parties will often wish to make express provision for the extent to which the process is to be confidential, and the circumstances in which the outcome of an arbitral process may be disclosed to others (e.g., providing for the outcome of the proceedings to be disclosed to the parties' bankers or auditors).

Parties should recognise the limits on the confidentiality of the arbitral process. Failure to adhere to the terms of an award will usually permit the other party to have the award recognised as a court judgment, with confidentiality being lost.

## Ability to choose the members of the tribunal and the procedure

Specifying arbitration will also usually allow the parties to provide for the qualifications and characteristics of the person or persons who will determine their disputes, and the manner in which they will do so. We consider these issues below as part of our discussion of the terms promulgated by the London Maritime Arbitrators Association (LMAA).

London arbitration (under the LMAA Terms) is the jurisdiction of choice, and English law is often the governing law of choice, for these type of disputes are owing to a number of reasons best summarised as follows. First, London is historically the pre-eminent forum for international maritime (including shipbuilding) disputes and it has more recently developed a strong reputation in international construction disputes. This is in no small part owing to the advent of the Arbitration Act 1996, which provides an effective framework for the conduct of international arbitrations with limited scope for court interference. Second, there is a substantial and very well advanced body of English contract law, much of which has developed in the context of maritime and construction disputes, so English law is well suited to governing these types of project. Third, London has a number of specialist legal practitioners in the field of shipbuilding. Finally, and perhaps of most significance to international parties with acute concerns about the neutrality of the chosen jurisdiction, London arbitrators (and the English courts) are held in high regard for impartiality and integrity.

## Arbitrating under the LMAA Terms

While the LMAA is certainly the pre-eminent arbitration body for the determination of offshore vessel construction disputes, it does not administer or supervise the conduct of its arbitrations or provide institutional help in the traditional sense. Instead the LMAA provides a set of rules, referred to as Terms, that the parties agree will govern any arbitration proceedings. LMAA arbitrations are, therefore, not dissimilar to ad hoc arbitrations.

The LMAA has introduced new Terms that are applicable to arbitrations commenced on or after 1 May 2017.<sup>3</sup> They are, however, very much a minor refinement of those previously in place and provide, to use the LMAA's own language,<sup>4</sup> for a 'light' touch approach covering key aspects of the arbitration but leaving considerable scope for the parties to adopt procedures to suit the case. To some extent the LMAA Terms do not add a great deal to the structure already in place under the Arbitration Act 1996, but they do provide a tried and tested framework for the resolution of shipbuilding (including offshore vessel construction) disputes.

Therefore procedures that require the input of the arbitration body (for example, emergency arbitrator provisions as found in the rules of many of the major arbitral institutions<sup>5</sup> or the procedure for the scrutiny of awards as found in the ICC rules) are absent from the LMAA Terms precisely because they are not appropriate for the *ad hoc* style LMAA environment.

### Establishment of the tribunal

The LMAA Terms provide for a simple mechanism for the establishment of the tribunal. The default position is for a tribunal of three arbitrators, with each party choosing one arbitrator at the outset of the arbitration, and the two party-appointed arbitrators choosing a chairperson. In practice it is very often the case in LMAA arbitration that the preliminary stages – up to and sometimes beyond any procedural hearings following the exchange of initial written submissions – are conducted by the party-appointed arbitrators alone. Provided that the two arbitrators can agree, the parties and their counsel are generally content with this approach and it reflects the flexibility inherent in LMAA arbitrations. This can be contrasted with the rules of some of the institutional arbitral bodies where the parties, and their appointed arbitrators, have less autonomy.<sup>6</sup>

While LMAA members are capable of hearing a broad range of disputes, including offshore shipbuilding disputes, unless the parties agree otherwise in the arbitration clause (which is rare in offshore construction projects), the LMAA Terms themselves place no restrictions on the parties' choices of arbitrator. Hence the expertise of the LMAA members is supplemented by a number of senior English lawyers (including retired judges) with significant experience of, and expertise in, arbitrating disputes in the offshore construction sector and who are available for appointment as arbitrator whether or not they are members of the LMAA. It is therefore common to find tribunals made up of at least two senior English lawyers, with the third member sometimes having a technical industry background depending on the nature of the dispute. That those involved in offshore vessel construction arbitrations are comfortable with this position is a reflection of both the sophistication of the parties and the reputation of English law and London arbitration.

---

3 For present purposes the focus is purely on the main body of the LMAA Terms. While the LMAA does also have intermediate and small claims procedure, these are unlikely to ever apply in an offshore vessel construction dispute.

4 Refer to the LMAA's Explanatory Note (dated 1 February 2017) to the new LMAA 2017 Terms.

5 See, for example, the LCIA Rules, 2014 edition (at Article 9B) and the ICC Rules, 2017 edition (at Article 29).

6 See, for example, the LCIA Rules pursuant to which all appointments are made by the LCIA Court.

## Procedure

Following the constitution of the tribunal, the procedure in LMAA arbitrations tends to follow that adopted in the English courts, with the exchange of written submissions followed by disclosure and thereafter factual and expert evidence. Parties are not hidebound to a particular approach and procedural steps (such as disclosure and the provision of expert evidence) can be tailored to the particular characteristics of the dispute. Furthermore, and particularly in the context of the construction of a complex offshore vessel, which must sometimes adhere in operation to quite stringent regulatory requirements, it is not unusual for parties to fall into dispute (during the course of the project) about how the vessel is being constructed in a specific respect. Resolving these issues at the time could be critical depending on the nature of the dispute and the extent to which adjustments to the construction of the unit can be made at a later time. In this event the parties are often assisted by the use of an expedited procedure that, although not formally provided for in the LMAA Terms, can be raised with the tribunal at the outset of the arbitration as soon as the party-appointed arbitrators are chosen and therefore before any steps are taken. In our experience, LMAA tribunals are always alive, and responsive, to the procedural needs of the parties.

## Related proceedings

While the LMAA Terms set out no formal provisions for the consolidation of arbitrations, this is rarely a consideration. In part because most offshore construction contracts significantly restrict the post-delivery liability of the builder (as discussed below), and with the possible exception of guarantee agreements (see below), invariably the only relevant protagonists are the builder and its buyer. The LMAA Terms do, however, expressly permit the tribunal to deal with two or more arbitrations raising common issues of fact or law concurrently (i.e., the proceedings are still separate), which can be helpful in offshore vessel construction disputes where ‘sister’ units are under construction at the same shipyard.

Guarantee agreements between the buyer and the builder’s bank providing for the refund of pre-paid delivery instalments in the event of cancellation of the shipbuilding contract by the buyer, are often made subject to English law and English court jurisdiction. In normal circumstances this is of no consequence because these guarantees will not respond until the arbitration between the buyer and builder is concluded. In the event of related guarantee proceedings taking place in the English courts at the same time as the underlying arbitration, while this could lead to the risk of conflicting decisions, there may be scope to stay the court proceedings pending the outcome of the arbitration.

## The award

The LMAA Terms provide that the award should be available within six weeks. While this is rarely realistic in the case of a substantial rig-delivery dispute, in our experience LMAA arbitration tribunals are diligent in the production of their awards, and in all but the most complex cases the award can be expected approximately three months following the conclusion of the hearing. The pedigree of the tribunals appointed in these arbitrations also maintains a high standard of awards such that practitioners and parties involved in these

disputes have not sought to lobby for the introduction of a scrutiny process similar to that found in the ICC Rules.

### **The types of disputes arising from these projects**

Disputes relating to offshore vessel construction projects can broadly be divided into two groups: those relating to events before the vessel is delivered, and those relating to events after delivery.

Dealing first with pre-delivery disputes, the type of dispute that is likely to arise is often determined by the state of the market. The period between when the contract is signed and the contractual date of delivery of the vessel is often in the region of two and a half to three years. As has only been too clear in recent years, the state of the offshore market can change dramatically during this period. This will affect the market value of the vessel at delivery, and therefore whether the buyer is paying more or less than the current market value. The state of the offshore market at delivery may also affect whether the buyer has a drilling contract for the vessel after delivery.

These two factors may significantly cool the buyer's enthusiasm for taking delivery of the vessel. Further, as the financing for the delivery instalment of the contract price in the construction contract is often secured against the income stream from the drilling contract after delivery, the absence of a drilling contract may mean that the buyer is unable to pay the delivery instalment, particularly if the contract price is significantly in excess of the then market price of the vessel.

### **Likely pre-delivery disputes in a falling offshore market**

So in a poor offshore market, the buyer may well be looking for a reason to cancel the contract, rather than take delivery.

Normally, the construction contract will provide for a contractual delivery date. If the builder does not deliver the vessel by that date, after a few days of grace, the builder will become liable for liquidated damages for delay. If the delay in delivery continues for a specified period through the fault of the builder, normally in the region of 210 days (the cancelling date for builder delay), the buyer may cancel the construction contract and obtain a refund of the pre-delivery instalments of the contract price, plus interest.

The buyer may also be entitled to claim damages for its losses, although these are normally excluded under the terms of the contract.

But even without a claim for damages, in circumstances where the market value of the vessel is substantially less than the contract price, a full refund of the pre-delivery instalments plus interest will be an attractive option for the buyer.

In addition, if the total delay including certain types of permissible delay such as force majeure exceeds a specified period (the 'drop-dead date'), the buyer will normally have an additional contractual right to cancel the contract.

The buyer's remedy for cancellation on the drop-dead date is normally the same as cancellation on the cancelling date for builder delay; namely, the buyer obtains a refund of the pre-delivery instalments of the contract price, although the buyer normally does not get interest, or only gets interest at a lower rate.

The key issue in these cancellation disputes is generally whether the builder is entitled to an extension of time, and therefore whether the relevant cancellation date had arisen when the buyer purported to cancel.

If the cancelling date had not yet arisen, then the purported cancellation by the buyer is likely to be a repudiatory breach of contract, entitling the builder to accept that cancellation as bringing the contract to an end, and to claim damages.

The circumstances under which the builder is entitled to an extension of time will vary, depending on the terms of the contract and which cancellation right has been exercised by the buyer. But it is likely that variations ordered by the buyer, or other delays for which the buyer is responsible, will in theory entitle the builder to an extension of time. Bearing in mind that these are highly complex construction projects spanning a number of years, these disputes can be complex and time-consuming, particularly if the builder is adopting the approach of claiming every conceivable potential extension of time, and hoping that at least some of these claims will be upheld.

These disputes are likely to involve a substantial amount of factual evidence as to the causes of the potential delay. They are also likely to require technical expert evidence on, for example, whether the claimed causes of delay were in fact the responsibility of the buyer, or simply part of the builder's scope of work in developing the design to produce a vessel that complies with the contract. There is also likely to be expert evidence from delay experts on whether the alleged causes of delay were on the critical path and therefore did result in overall delay to the delivery of the vessel.

The complexity of the arbitration will be substantially increased if the builder purported to tender the vessel for delivery before the buyer served its cancellation notice.

In offshore construction contracts, one of the most difficult areas is to determine precisely when the vessel is in a deliverable condition, and therefore can be tendered for delivery by the builder. Normally, the contract does not require every minor defect in the vessel to be rectified before delivery. This is because a delay in delivery of the vessel can have significant financial consequences for the builder, not only as a result of its liability to pay liquidated damages for delay under the contract, but also because of the delay to the payment of the delivery instalment by the buyer. So the contract normally specifies that the vessel can be delivered with minor defects, provided these do not affect the safety or operability of the vessel and are remedied by the builder as soon as possible after delivery.

If the builder has purported to tender the vessel for delivery before the buyer tries to cancel, then in addition to arguments as to whether the builder was entitled to an extension of time, and therefore the buyer cancelled too early, there will also be an argument whether the vessel was in a deliverable condition when tendered for delivery.

The deliverability issue will involve factual evidence as to the existence of the defects, as well as expert evidence on the consequences of any such defects. Again, if the buyer adopts a scattergun approach as to which defect or defects prevented the vessel from being in a deliverable condition, this can greatly increase the time and cost involved in the arbitration.

### Likely pre-delivery disputes in a rising offshore market

In a rising market, it is very unlikely that the buyer will want to cancel the contract. In these circumstances, it is likely that the offshore construction market will also be overheating and the builder will have experienced significant cost overruns and delays. The builder

may therefore attempt to claim extensions of time to avoid liability for liquidated damages for delay, or to claim that it is entitled to additional payment in respect of alleged variations to the work, or to compensate the builder for implementing measures to accelerate the project. These disputes are therefore generally less substantial than cancellation disputes.

This, however, assumes that the construction contract has limited the buyer's claims for damages for delay in delivery to a fixed amount of daily liquidated damages up to a cap. In a rising market, these are unlikely to compensate the buyer fully for its real losses flowing from the delay in delivery, particularly if the buyer is not only losing out on revenue from the vessel, but is also itself subject to liquidated damages for delay payable to its client under the drilling contract. If the exclusion provisions in the contract are not watertight, the buyer may well seek to bring a very significant claim for damages for delay.

### Post-delivery warranty disputes

Given the complexity of offshore-unit construction projects, it is inevitable that they will often not be built to the contractually required standards such that, irrespective of the oil price at any one time, disputes will arise upon delivery in respect of perceived construction defects.

Given the enormous revenue-earning capacity of these units, the financial consequences of a defect may be extreme. Builders therefore aim to contractually limit liability in respect of post-delivery problems, whereas buyers aim to secure express rights against the builder to have quality issues rectified promptly and at minimal cost so the unit may be quickly redeployed back into lucrative employment.

The parties' competing interests will typically be reconciled within the 'warranty of quality' provision that can be found in almost all such construction contracts. Offshore units are typically built pursuant to certain industry-standard contracts, though these will be heavily negotiated and modified. Despite this, the warranty provisions will often adopt a similar approach.

### *The warranty period*

A warranty period will usually be provided for (often 12 months), typically running from the date the unit is delivered to and accepted by the buyer during which, if a defect materialises, the builder's warranty obligations will be invoked.

The contract will specify what parts of the unit the builder warrants against defects during the warranty period – typically the vessel and all parts, machinery and equipment that are designed, manufactured or furnished by the builder.

The warranty will usually provide that these will be free of defects resulting from causes such as defective materials, miscalculation, poor workmanship or failure to construct in conformity with the contract, as well as specifying the types of defects that are not covered, which may include (but not be limited to) those arising from 'perils of the sea, rivers or navigation', normal wear and tear, overloading, improper loading and stowage, fire, or by alteration or addition by the buyer not previously approved by the builder.

A great many arbitrations arising from such construction projects involve determining whether a defect falls within the warranty provisions or is excluded.

### *Nature of the buyer's and the builder's obligations*

The warranty provision will usually require the buyer to make prompt notification when a defect is discovered. Depending on the clarity of the drafting, failure to do so may give rise to a dispute about whether this sounds only in a claim for damages by the builder (i.e., in the event that it has increased the builder's ultimate cost of repair) or whether the buyer's right to a repair is lost.

There will usually be a longstop date (often a specified number of days beyond the end of the warranty period) by which the occurrence of a defect must be notified. Failure to do so will usually expressly absolve the builder of any responsibility.

Assuming that proper notice has been given, the builder's primary obligation will usually be to remedy at its shipyard and at its expense, whether by repair or replacement, any defect against which the vessel is warrantied.

Such contracts, however, will usually provide for circumstances in which the owner will be entitled to have repairs undertaken other than at the builder's shipyard. It will often be provided that the builder will be obliged to reimburse the owner's resulting costs (or to pay some other measure of reimbursement, for example, the costs that would have been incurred if the work had been undertaken at a leading Asian shipyard). In the context of an owner, focused on maintaining the uninterrupted employment of its highly lucrative asset and so seeking to have repairs carried out as locally as possible, and a builder, wishing to carry out repairs at its own shipyard and so at lower cost than elsewhere, the potential for disputes is again high.

### *Extent of the builder's liability*

The warranty provisions will typically also seek to restrictively define and limit the entitlement of a buyer to recover compensation in respect of losses suffered and costs incurred when defects have arisen.

A critical issue is often whether the warranty provision should be construed as a 'complete code' of the parties' obligations for post-delivery defects – as providing positively and exclusively for the entire extent of the builder's obligations (and buyer's rights) with all obligations otherwise arising excluded – or was it intended simply to provide additional rights to those arising under common law?

Post-delivery defects necessitating repair will typically give rise to significant financial consequences for a buyer. Any builder will therefore want to provide for the warranty provisions of the construction contract to stand as a complete code of the parties' rights and obligations and to curtail any entitlement of the buyer otherwise to recover financial losses resulting from post-delivery defects. The builder will want to confine the buyer solely to a right to have defects remedied (whether at the builder's shipyard or elsewhere in the limited circumstances provided) but with no other compensation being payable.

While commercially minded arbitral tribunals will often anticipate that the builder's intent was to so limit the rights of the buyer, great care must nevertheless be taken by builders in the drafting of warranty clauses that are intended to provide for such a 'complete code', as tribunals will be reluctant to find for such a serious consequence in the face of loose or ambiguous drafting.

An examination of how builders will seek to limit the extent of their liability for post-delivery defects is beyond the ambit of this chapter.

However, having positively defined its obligations in respect of defects, a builder will commonly seek to provide that all other rights arising on the part of the buyer, whether pursuant to the contract or by the operation of law or otherwise, will be excluded and that the buyer's rights will be solely confined to those detailed within the warranty provision. Care will be taken to ensure that any liability arising by law as to the quality of the unit, in particular under the Sale of Goods Act 1979, will be excluded. Further, the builder will typically then provide that all other financial consequences resulting from defects fall for the account of the buyer.

An astute buyer will during contract negotiations typically seek to secure as much potential for recourse against the builder as it can, having in mind the serious financial consequences that may result from defects. Given that these contracts will often have been signed following an intense period of face-to-face negotiations between buyer and builder, the potential for the drafting to give rise to disputes is again extremely high.

### **Strategies for success in the arbitration of these disputes**

Only foolhardy practitioners would believe that they alone are able to determine the outcome of an arbitral process. Rather, myriad decisions and factors will ultimately impact on the outcome of any arbitration. The experienced and pragmatic practitioner will recognise this and, while ensuring that the client is always reminded of the risk inherent in the arbitral process, will seek to minimise that risk as far as possible by the adoption of sensible strategies and practices for the resolution by arbitration of the highly complex disputes that commonly arise from these projects.

It is beyond the limits of this chapter to provide a full analysis of how best these disputes may be resolved by way of arbitration. We highlight below some of the key ways in which a party may be able to maximise its prospects of success in a complex offshore unit construction-related arbitration.

In our experience, a primary strategic objective, whether pursuing or defending a claim, is to identify as early as possible what will be the narrative of the case to be advanced on behalf of the party in question. Doing so allows for a focusing of effort and resources in the pursuit of the party's case through to the conclusion of the proceedings.

A number of steps can be taken with the aim of achieving this objective.

For example, a key early step in any arbitral process is to ensure that all potentially relevant documents are gathered and collated as soon as possible. Any document-destruction policies should be promptly suspended and a full and considered analysis undertaken as to the location and nature of documents that may be held by the party relating to the dispute. In an age of electronic documents, which has hugely increased the burden of undertaking disclosure, the key is to ensure that all relevant material is captured. A failure to do so will lead to failures to disclose relevant documentation and perhaps, in a worst case scenario, to an inability to do so if the material is subsequently lost or destroyed. The resulting impact on a party's credibility in the eyes of the tribunal may in such a case be sufficient to turn the outcome of the arbitral process.

Care should be taken early to identify a party's key factual witnesses who should be briefed on what is required of them, with resources being committed early to working with the witnesses to ascertain and record the relevant facts. A case will often be won or lost based on the performance of a party's factual witnesses in cross-examination. It is therefore

always a sound investment of time and money to ensure that witnesses are educated as to the level of detail that they will be required to provide in their witness evidence and the extent to which they will ideally need to substantiate their evidence with contemporaneous documentation.

Similarly, early identification of the relevant expert issues that are at the core of the dispute, and then the prompt and careful identification and appointment of appropriate experts, can significantly enhance the prospects of success in arbitration. Further, the early involvement of an expert allows for the prospect of it being determined earlier in the process that the case is likely to turn on matters of expert rather than the factual evidence. If so, the experts may be able to provide guidance as to the nature of the factual evidence that is required, and so avoid a more extensive and costly factual evidence gathering process. The early appointment of experts may similarly allow for a 'sense check' to be performed in respect of the factual evidence provided by the witnesses and can be a check against partisan factual witnesses, who would be susceptible to being discredited in cross-examination at the final hearing.

In arbitrations as complex as those that often arise in these substantial construction projects, organisation and the early determination of a party's case will often be key. This will also tend to be effective in giving rise to the possibility of exploring an early settlement that would avoid the substantial costs involved in a full and final arbitral hearing.

# Appendix 1

## About the Authors

### **James Brown**

Haynes and Boone CDG, LLP

James Brown, partner with the contentious department, has more than 15 years of experience as a disputes lawyer. His primary focus is litigating and arbitrating complex, high-value engineering and construction disputes for international clients operating in the shipping and offshore oil and gas sectors. Having been recommended in the international arbitration, oil and gas, and shipping sections of the most recent UK edition of *The Legal 500*, the international directory of law firms, which reported that James Brown ‘provides tremendous attention to detail in high-value technical disputes’. James continues to be recommended in the latest edition (2019) of *The Legal 500*. It reports in connection with his ranking in the international arbitration section that James is ‘highly attentive and keeps clients informed’, and in connection with his ranking for shipping that he ‘regularly handles arbitration and litigation’ and is a ‘key figure’. He pursues and defends claims, including in relation to the deficient performance of contracts; contractual variations; responsibility for delay and related cost-overruns; defects and warranty issues; and in respect of associated guarantees, and appeals, challenges and enforces court judgments and arbitral awards resulting from such claims. His experience extends to claims in the English High Court, including the Commercial Court and Technology and Construction Court, and in arbitration (including under the rules of the London Maritime Arbitrators Association (LMAA), the London Court of International Arbitration (LCIA) and the International Chamber of Commerce (ICC), as well as the UNCITRAL rules and those of the Chartered Institute of Arbitrators). James also assists clients to obtain orders (including freezing orders) from the English court in support of both domestic and foreign court or arbitral proceedings. James regularly writes, lectures and provides seminars on current dispute resolution issues.

### **William Cecil**

Haynes and Boone CDG, LLP

William Cecil is a partner and head of the contentious team in London, with extensive arbitration experience in offshore oil and gas and energy. He has recently been involved in an ICC arbitration in Geneva relating to a power and desalination construction project in the Middle East; an SCMA arbitration in Singapore relating to a rig upgrade; an LMAA arbitration and associated High Court proceedings relating to the construction of two drilling rigs in China; an LMAA arbitration relating to the termination of a construction contract for an offshore unit; and two related arbitrations arising out of the termination of a long-term offshore drilling contract. William is a recommended lawyer in the international arbitration and shipping sections of the 2019 UK edition of *The Legal 500*, Legalease, the international directory of law firms. It reports that he is ‘calm and experienced.’ *Chambers UK* (2019) ranks William as a notable practitioner in the shipping category saying he is ‘an experienced shipping lawyer who routinely acts for clients in litigation and arbitration. He has expertise advising clients in the negotiation and drafting of offshore contracts.’

### **Andreas Dracoulis**

Haynes and Boone CDG, LLP

Andreas Dracoulis is a partner and disputes lawyer helping clients resolve problems in the energy, shipping and construction sectors. Andreas mostly advises on international projects ranging between the construction of offshore units and ships, upstream exploration and production and major infrastructure works. He has represented clients in international arbitrations conducted under many of the commonly used rules and in the English courts. Andreas holds a postgraduate master’s degree in construction law and dispute resolution and he is a recommended lawyer in the 2019 edition of *The Legal 500*, which reports that Andreas is a ‘key name’ in international arbitration and is ‘building an excellent reputation for careful case management’ in shipping.

### **Haynes and Boone CDG, LLP**

29 Ludgate Hill

London EC4M 7JR

United Kingdom

Tel: +44 20 8734 2800

Fax: +44 20 8734 2820

[james.brown@haynesboone.com](mailto:james.brown@haynesboone.com)

[william.cecil@haynesboone.com](mailto:william.cecil@haynesboone.com)

[andreas.dracoulis@haynesboone.com](mailto:andreas.dracoulis@haynesboone.com)

[www.haynesboone.com](http://www.haynesboone.com)

The energy industry shaped international arbitration and – thanks to resource nationalism, changes in the oil price, shifting geopolitics and febrile sanctions lists – remains one of its biggest users.

*The Guide to Energy Arbitrations*, published by Global Arbitration Review, provides coherent and comprehensive coverage of the most common, most difficult, and most unusual issues faced by energy firms, from some of the world's leading authorities. It's edited by J William Rowley QC, Doak Bishop and Gordon Kaiser.

The Third Edition is fully updated and has new content on upstream oil and gas disputes.

Visit [globalarbitrationreview.com](http://globalarbitrationreview.com)  
Follow @garalerts on Twitter  
Find us on LinkedIn

ISBN 978-1-78915-099-5