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COMING OUT ON TOP AGAIN

An Offshore Contractor's Guide through the English law issues arising from the latest oil price collapse and COVID-19

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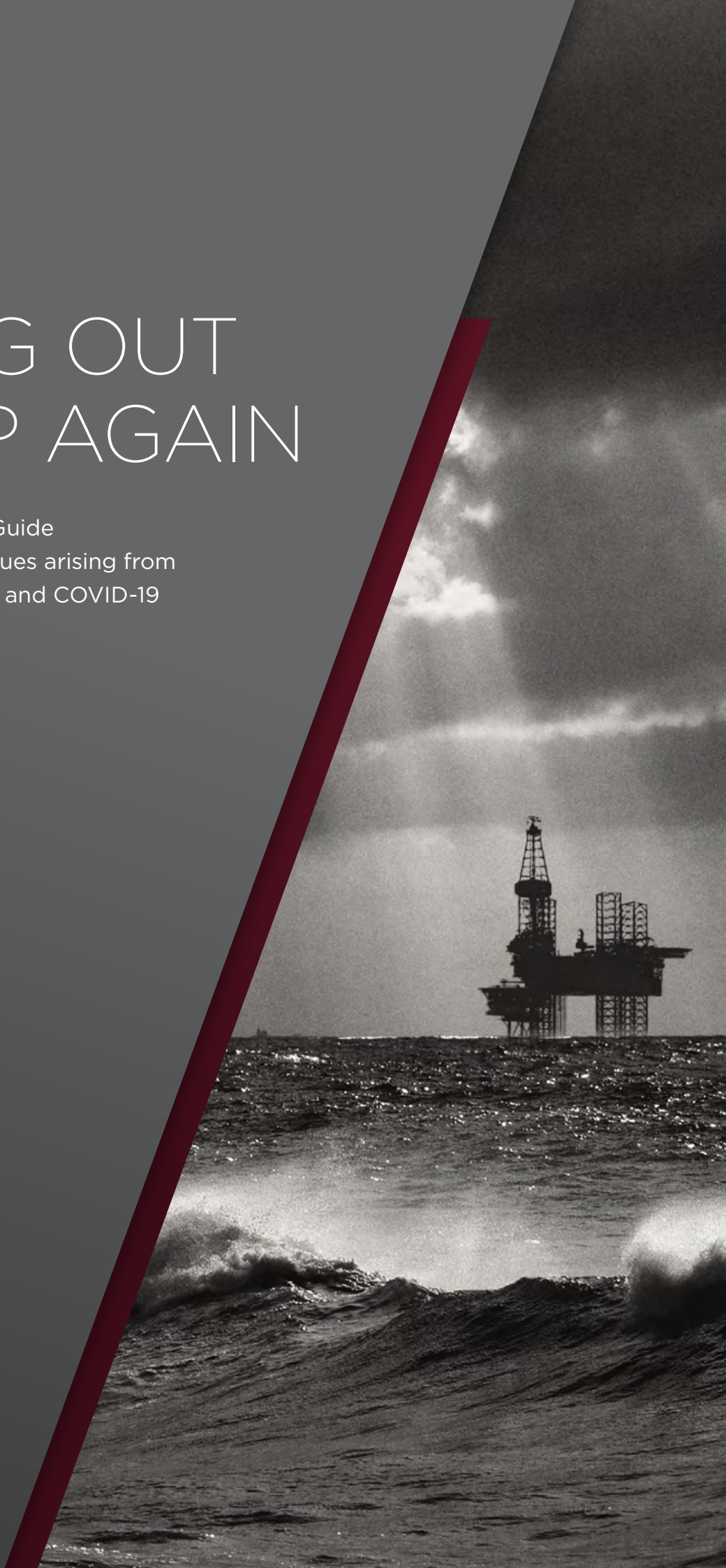

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A. INTRODUCTION

1. The new reality

As a result of the sudden and dramatic fall in the oil price that had occurred between June 2014, when oil had been trading at prices of around US$115 per barrel of Brent crude, to January 2015 by which time it had fallen to around US$35 per barrel, I was prompted to prepare a "Guide for Contractors". Parties in the offshore oil and gas sector, and in particular contractors in the industry, were facing turbulent and unpredictable times. Survival was the name of the game for many participants and the Guide was prepared to provide contractors with some insights concerning the typical issues that arise under English law in certain commercial scenarios that would have been common in the circumstances and to provide suggestions for best navigating a way through those scenarios and the associated legal issues.

In the intervening period, the market never returned to the heights of 2015, but as a result of the economies and efficiencies developed in respect of the exploration and production process during the period that had followed the collapse in the oil price, combined with increases in the price of oil to highs of around US$86 per barrel in October 2018, a very large number of participants in the market had managed to sustain themselves and their business operations.

However, in what is turning out to be an unprecedented period of time for the world and the global economy, in only the last month or so again we have had a dramatic and sustained fall in the price of oil to a current price at the time of writing of US$25 per barrel, with the immense and unprecedented issues facing the world and our global economy as a result of the COVID-19 pandemic layering further huge difficulties on top of those already facing offshore oil and gas contractors.

In the circumstances, it seems an opportune time to return to and revise the previous Guide so as to again provide some high-level guidance concerning commercial scenarios that parties may increasingly be facing in the present circumstances and the approach of English law to these issues.

I do of course recognise that the present circumstances are, it is fair to say, beyond the realms of what was comprehensible and foreseeable only several weeks or so ago. As such, I certainly do not claim that this revised Guide will provide the reader with all of the answers to the no-doubt extremely difficult and unusual scenarios that will be playing out in the industry. However, I hope that this Guide will provide at least some assistance towards steering the best course through these issues by providing a high level understanding of what the issues under English law may be, and how our law might determine them.

B. COMMON SCENARIOS

In broad terms, commercial parties in the offshore oil and gas sector will undoubtedly be ever more facing the following scenarios in light of the immense pressure that has been applied to the market first as a result of the oil price dramatically falling but also now in light of the COVID-19 crisis and the impact of this generally on the world's economy:

i. prospective counterparties looking to *exit negotiations* for prospective contracts;

ii. counterparties looking to *terminate* existing contracts; and

iii. counterparties *defaulting* under existing contracts.

Each of these scenarios and the issues arising are considered below.

1. Issues arising in the negotiation of *prospective* contracts

The recent dramatic fall in the price of oil, combined with concerns regarding the impact of the COVID-19 pandemic crisis, will undoubtedly be impacting upon the willingness of parties to commit to new contractual arrangements. Many contractors who have been engaged in long running commercial discussions will suddenly be finding their counterparty no longer wishes to commit investment to the new project that had previously been anticipated but instead wants to walk away from the discussions. In these cases, however, contractors will often have spent a great deal of time and money in connection with the negotiations, expecting a deal to be concluded.

Situations such as this, particularly in the current market where alternative deals may not be readily available, can leave a contractor who has invested heavily in such a prospective deal deeply aggrieved and looking for redress. Questions that arise can include:

i. whether the other party is legally entitled to walk away; and

ii. whether the money invested in the commercial negotiations and now "wasted" is recoverable by the contractor from the party walking away.

Answers to questions such as these will always depend very heavily upon the precise factual circumstances. There will always have to be a careful examination of the communications that have been exchanged between the parties during the negotiation process, including the emails and other correspondence and any drafts of agreements that have been produced, as well as an examination of what has been said during meetings.

However, a number of broad propositions may assist in an assessment of a party's rights.

(a) Can a potential client or other commercial party simply walk away without consequence from the negotiations for a new contract?

Generally speaking, unless a contract has already been concluded, English law *will* usually consider a commercial party to be entitled simply to walk away from commercial negotiations with a contractor. In this sense, English law does not typically regard a party to be in law *obliged* to continue discussions relating to a deal it no longer wishes to pursue (and so does not require it to pay compensation to the other if it does not so continue the discussions).

Often, however, the parties to a negotiation about a prospective transaction will have sought to impose, typically in some document which is preliminary to their anticipated final contract (for example in a "letter of intent", "heads of agreement" or similar) an "obligation" to *negotiate* or to *endeavour to reach agreement*, or similar, on the matters detailed in the particular document.

Parties, however, are often surprised to find out that, as a matter of English law, any such attempt to seek to impose an obligation to continue to negotiate or to reach an agreement may not be recognised as having any binding legal effect.

In numerous cases the English courts have held that an express agreement merely to negotiate does not constitute an enforceable contract because it is too uncertain to have any binding effect in law. Such an agreement does not therefore impose any legal obligation to negotiate or to use best endeavours to reach agreement or to accept proposals that with hindsight might appear to be reasonable.

If an agreement to negotiate is so uncertain as to not be binding, the English courts will not therefore usually cure this by implying into the parties' agreement a term such as, for example, to negotiate in good faith.

Indeed, the English courts have determined that even an agreement to *lock-out* other parties from a commercial negotiation – i.e. to negotiate on an exclusive basis – may be (if not drafted with sufficient precision) insufficiently certain to give rise to a binding obligation to do so. In one of the leading cases - *Walford v. Miles*[1] - the House of Lords (as the highest

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1
[1992] 2 A.C. 128

court in England and Wales was then titled) held that such a "lock-out" agreement will not be enforceable in law if it does not provide for a fixed period of time during which third parties are to be locked out from the negotiations. Further, the Court unanimously rejected the argument that a term should be implied requiring the vendors to continue to negotiate in good faith with the purchaser for so long as the vendors continued to desire to sell, since such a term was itself too uncertain to be enforced. The problem, the House of Lords said, was that it would be inherently inconsistent with the usual position of a negotiating party, who is in the ordinary case free to advance his own interests during the negotiations.

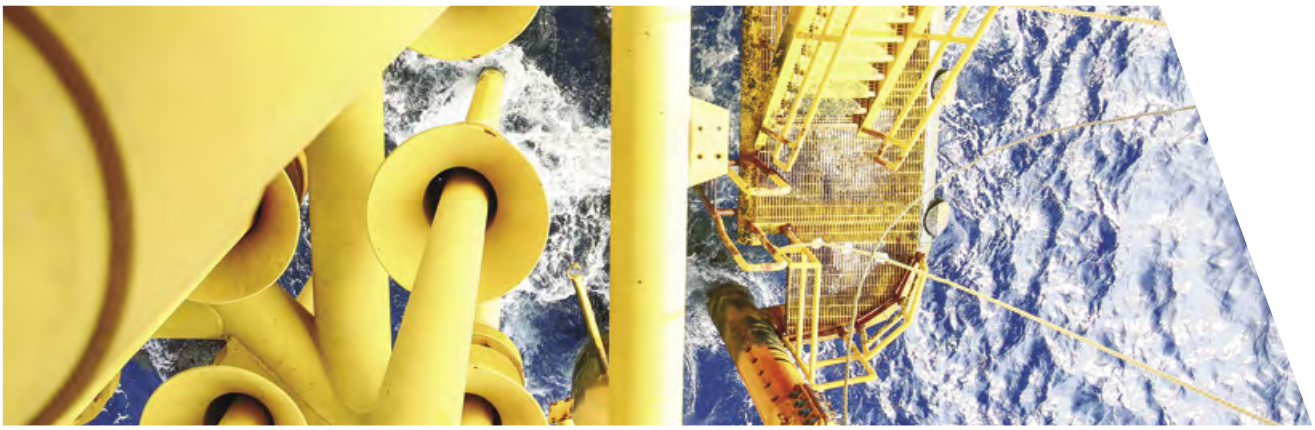
Generally, therefore, it is very likely (though always fact dependent) that your counterparty will be entitled simply to walk away from on-going negotiations with you. Unless you have agreed a sufficiently clear and certain obligation as to be enforceable as a contract, this is likely to be the case even when you have expressly sought to commit your counterparty to having to negotiate with you by means of a letter of intent or heads of agreement or similar.

This, however, will always depend on the precise circumstances and so legal advice should always be sought.

(b) Can a contractor recover its wasted costs when the other party walks away from commercial negotiations?

In such a case, a question we are commonly asked is whether a party is able to recover from the party who has walked away those costs which it has spent on the commercial negotiations. Typically, with high value offshore contracts, significant sums will have been spent during the commercial negotiations and a party will wish to seek reimbursement of those costs if it can.

Again, every case will turn on its facts, but an English court will generally be very unlikely indeed to allow for the recovery of such wasted costs from the party walking away from a negotiation in the absence of an express contractual provision requiring that party to pay them.



In cases in which there is an enforceable obligation to negotiate and a party is in breach by walking away, difficult questions may arise as to whether the innocent party can recover the profits it expected to make on the anticipated transaction. It does not necessarily follow that the other can recover substantial damages. Much will depend on the terms of the obligation and the nature of the losses. Further there may need to be a complex analysis as to what the prospects were of a deal actually being concluded had the other party not walked away. It may be that the innocent party's losses will be discounted in accordance with the chance that the anticipated transaction would actually have been agreed.

KEY POINTS

In the event of an aborted prospective deal consider:

Had the parties agreed with sufficient certainty terms as to a basis on which they were contractually *required* to negotiate?

If no: either party can walk away.

If yes: to walk away may be a breach of that agreement. In that case, a claim for damages may be brought by a contractor, but only if the breach resulted in recoverable loss.

In the present environment, where the commercial pressures are such that prospective deals may be aborted before a contract is concluded, contractors would be well advised if possible to secure prior agreement from the other party to contribute towards the costs that will be wasted if that party walks away from the negotiations.

(c) Has a binding contract already been agreed?

In a case involving a reluctant counterparty who has walked away from a negotiation, we would always wish to consider for a contractor whether a contract has actually *already* been concluded.

The reason is that the English law requirements for the creation of a contract may well often be less than commercial parties assume to be the case. If a contract has already been concluded on favourable terms, a commercial party will want to enforce that contract (whether by recovering damages for loss suffered if the other party cannot or will not perform, or by compelling the other party to perform as promised).

Whilst this Guide is certainly not an appropriate place for a full examination of the principles of English law which are relevant to the question of whether a binding agreement has been reached, a very basic overview may be useful.

In short, a contract will under English law be reached when the following elements are present:

i. two or more parties;

ii. who intend to enter into legal relations;

iii. have reached an agreement, involving the acceptance of terms offered by one or more to the other(s);

iv. there is sufficient certainty as to those terms; and

v. "*consideration*" (by which English law means something of value "moving to" the promisor or a detriment assumed by the promisee) is provided.

There are weighty textbooks concerned with the detail of the above! However, the essence of what is required for a contract to be formed is hopefully clear.

Crucially, it is worth emphasising that whether a contract has been formed will be determined on an *objective* basis, which means (perhaps surprisingly) that it does not generally matter whether the parties themselves think they have reached an agreement or what they think are the terms of their agreement. Potentially, therefore, a commercial party might purport to walk away from negotiations with a contractor, believing it is entitled to do so without consequence, yet there may already be a legally binding contract which can be enforced by a court or arbitral tribunal. This may be so even if the parties themselves did not realise this (for example, because they were continuing to negotiate the finer detail of their agreement).

In working with clients to determine their rights in the present circumstances, particular aspects of the above will be of critical importance in the analysis of whether a contract has already been concluded and can be enforced.

i. Be careful with offers!

Without an offer there can be no contract. However, parties who have recently been engaged in commercial negotiations, and who have received an offer of terms by another to enter a contract (perhaps made before the present situation developed as it has) should bear in mind that any offer previously made can be withdrawn at any time before it has been accepted. In the current environment, therefore, where new business opportunities may be limited, a party should not proceed on the basis that, where it has received an offer, it can take its time to decide whether the offer is attractive and one that the party would wish to accept.

What may be more surprising, however, is that the English courts have held that, even if an offer is expressed to be made and able to be accepted for a certain specified period of time, the offeror is nevertheless perfectly

entitled to change its mind and withdraw the offer before the expiry of the specified period. The reason is that an offer is entirely gratuitous. Nothing of value will have been given by the recipient of the offer and, as such, there is no *consideration* in the eyes of the English courts and so no contract to be breached upon the withdrawal of the offer.

The key point, therefore, is that if a commercial offer of terms is a good one that is commercially acceptable to the offeree, then that party would be wise to act promptly to secure the relevant contract by accepting the offer. This is to avoid the possibility of the other party withdrawing its offer and walking away from the prospective deal before a contract is concluded.

Conversely, care should also be taken to ensure that offers which a party would no longer wish to be accepted are not inadvertently *"left on the table",* because in such a case they generally remain open for acceptance unless and until they are revoked.

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In the case of a contractor operating in the offshore sector, this issue might arise, for example, when a number of offers have been made to commercial parties in the business of providing support services to the contractor. If such an offer to contract (e.g. to receive and pay for certain services or supplies) has been made by an offshore contractor and the contractor no longer wishes to secure the provision of the services/supplies offered by the supplier (because, for example, the offshore contractor is looking to reduce its outgoings in light of the changed environment), then it is essential for the contractor to ensure that his withdrawal of any offer is effectively communicated to the supplier. Otherwise, suppliers in the current market may seize upon an offer that, from a strict legal perspective remains on the table, to secure what would be a valuable contract in this difficult environment.

It should be emphasised that it is not sufficient for the contractor that wishes to withdraw an offer simply to act inconsistently with his earlier offer, for example by contracting with another supplier. This is because this would probably not be regarded as an effective withdrawal of the earlier offer. Rather, the supplier that may well be hungry for such contracts in the current commercial environment would still be able to accept the offer so as to give rise to a contract which would bind the contractor.

In the context of a commercial organisation, this does not mean that the withdrawal has to be brought to the actual notice of the officer responsible for the matter. However, communication of the withdrawal of the offer must be made effectively to the organisation.

KEY POINTS

Do not hesitate to accept an offer of attractive commercial terms.

Do not leave offers open if you no longer wish to contract on their terms.

If withdrawing an offer, ensure that notice of the withdrawal of the offer *actually reaches* the offeree.

ii. Do agreements need to be in writing?

Another issue that may be particularly pertinent in the current commercial context where counterparties have sought suddenly to withdraw from negotiations that have been afoot is whether the absence yet of any written agreement means that a contract has not been concluded.

The analysis can be complex. In circumstances where the parties had reached agreement on the key terms of a deal, and it is not apparent that a written document was intended for such a deal to be legally binding, the English courts will often find that a binding agreement has been reached despite a "formal" contract not having been recorded in writing.

Occasionally, therefore, the English courts will find that a written agreement was only to serve as evidence or a record of an agreement that had already been reached by, for example a prior exchange of written communications or, in a rare case, by oral statements made in a meeting or over the telephone (in which case an oral agreement may be found previously to have been concluded). Accordingly, it will often be helpful to seek legal advice to determine whether an agreement may have already been reached, despite your counterparty having purported to call off the negotiation and walk away.

KEY POINTS

If a counterparty walks away from negotiations, contending that no agreement was reached because there was nothing in writing or no signed document, this does not necessarily exclude an English court from finding that an agreement has already been reached.

2. Issues arising in respect of *existing* contracts

In respect of existing contracts, contractors will commonly be faced with questions such as the following:

a. Might (i) the changed economic circumstances or (ii) the COVID-19 pandemic be effective to reduce a client's obligations and/or excuse failure(s) by the client to adhere to the contract's terms?

b. How might a contractor that is sympathetic to its client's circumstances (perhaps with an eye on longer term commercial prospects) agree to continue its existing contractual arrangements with a client, albeit on different terms?

c. Faced with an unsympathetic contractor, might *the client* nevertheless be entitled unilaterally to walk away from an existing contract without sanction (i.e. without the contractor having any redress against it)?

d. What rights may arise if a client or other commercial party fails to perform its contractual obligations?

Although the answers to these questions will always depend on the particular facts of a case, we set out an overview below of the general position under English law.

(a) Might (i) the changed economic circumstances or (ii) the COVID-19 pandemic be effective to reduce a client's obligations and/or excuse their failure(s) to adhere to the contract's terms?

As a matter of English law, the freedom of commercial parties to determine their own commercial arrangements is generally recognised without significant limit.

As such, it is possible for commercial parties to make express, specific provision in a contract to provide for what are the consequences of an occurrence such as a collapse in the price of oil or of a public health crisis such as the COVID-19 pandemic. In such a case, we would generally expect a court or tribunal applying English law to uphold the parties' agreement as to the consequences (which the court would interpret in the usual manner, that is to say having regard to what the parties intended – judged objectively – in light of the background at the time when the contract was agreed).

Far more usually, however, the parties will not have expressly provided for the consequences of such a dramatic change in economic circumstances, and in that case clients or other contractual counterparties may look to other provisions of the contract to seek to alleviate some of the difficulties to which the situation has given rise.

i. The potential relevance of "force majeure" clauses

It is common to include a *force majeure* clause in many English law commercial contracts.

Broadly, such a term is typically intended to excuse one or both of the parties from further performance of the contract, whether in whole or in part, or to entitle one or both of them to suspend performance under the contract, or to claim an extension of time for their performance, or indeed to cancel the contract after a period of time, upon the occurrence of some specified event or events beyond their control that impedes the performance of their contractual obligations.

Such clauses are tightly controlled by the English courts and have led to numerous court judgments over the years.

Faced with a claim by a client or other counterparty that, for example, the change in the economic environment in the offshore oil and gas industry in the form of the recent collapse in the oil price is an event of *force majeure* entitling the client to be excused from performance of its contractual obligations, certain key issues will tend to fall for consideration:

i. *"Force majeure"* in itself has no commonly recognised meaning under English law. It will depend on the terms of the individual contract what is meant by this.

   Accordingly, at the negotiation stage of a contract, parties should take great care to seek to define precisely those matters which they intend to constitute events of *force majeure* under the contract.

   Faced with a *force majeure* claim by a client, we would wish to consider very carefully for a contractor whether the relevant events or occurrence relied upon properly falls within the relevant contractual provision.

ii. It will be for the party who seeks to rely on a *force majeure* event to prove that the facts are within the particular clause.

iii. In addition to proving that one of the relevant events has occurred, it will then generally also be for the party who relies on it to establish that it has prevented, hindered or delayed his performance (depending upon the wording of the relevant provision).

   If the clause requires the party to prove that he has been *"prevented"* from performing under the contract or is *"unable"* to do so, what must usually be shown is not merely that performance of the contract has become more difficult or unprofitable, but that its performance has become physically or legally impossible.

   If, however, what is required is to show that performance has been *"hindered"*, the English courts have given that word a wider scope.

iv. Further, the party seeking to claim *force majeure* will be required to prove:

a. that his non-performance was due to circumstances beyond his control; and

b. that there were no reasonable steps that he could have taken to avoid or mitigate the event or its consequences.

It will therefore be clear that very careful consideration must be given to whether a *force majeure* event has arisen such as to excuse a party from further performance under the contract, or to permit suspension or termination.

It is common, however, for *force majeure* provisions to specify that *"pandemic"* shall constitute *force majeure*. As such, many parties will have invoked *force majeure* provisions under their contracts when the World Health Organisation declared the existence of a pandemic on 11 March 2020. "Governmental restrictions or directions", or similar expressions, are often also similarly specified as being *force majeure* events, such that many commercial parties are currently invoking such provisions as governments around the world implement strict laws and issue directives concerning commercial activity in the current circumstances.

Force majeure clauses will typically specify the procedure by which any such claim to the benefits accruing from such a clause has to be made, and so the potential exists for a claim to fail if such procedure is not adhered to (this will depend on what the contract states).

Often, there will be a requirement to give notice of *force majeure* in writing within a particular period of time of the relevant *force majeure event* arising. In cases where this does not take place complicated questions about whether the giving of proper notice is a condition precedent to bringing a claim will arise. In other words, does a failure to give proper notice *prevent* a claim being brought (i.e. bar it), or is it just a breach of contract giving rise to a claim for damages for loss (if any loss can be shown)? Great care must therefore be taken by any party believing that it may be entitled to invoke a *force majeure* clause, to ensure that the correct steps are taken to claim the relevant benefit.

As to whether the recent drastic fall in the market price of oil might be found to constitute an event of *force majeure*, the position will always depend on the wording of the relevant provision. However, a number of cases following the 2008 financial crash considered whether as a matter of English law those events amounted to *force majeure* events under a number of different contracts, and generally speaking the courts in England were not sympathetic to such arguments. In our view, it would have to be very clearly spelled out in the contract that this was the parties' intention before any court applying English law would find that this constituted an event of *force majeure.*

KEY POINTS

We are not aware of the English courts having considered whether a collapse in the price of oil constitutes an event of *force majeure*, but in the absence of very clear express words, we would not expect that commercial parties will be able to rely on this as amounting to an event of *force majeure*.

It is, however, quite likely that the COVID-19 pandemic and/or governmental restrictions and directives implemented subsequent to this will constitute *force majeure* events under many commercial contracts (these matters are often expressly included within *force majeure* provisions on contracts). Parties should therefore check the terms of their contracts very promptly and act as required by the relevant provisions if they hope to secure the benefit of these provisions.

ii. The English law doctrine of frustration

The English common law[2] has long recognised a principle, which is distinct from that of *force majeure*[3], by which parties to a contract may be discharged (and so excused) from further performance of a contract and its otherwise required performance obligations when something takes place after the formation of the contract which either (1) makes it physically or commercially impossible for a party to perform its obligations or (2) transforms the obligations in the contract of something radically different from that which the parties had contractually agreed. In such a case, the contract is said to be "frustrated".

2
The "common law" means that body of law which is made by the courts through their judgments, rather than by the legislature.

3
Force majeure deriving rather from the parties' agreement itself.

In the current difficult low oil price environment, a party to a contract may try to rely upon this doctrine to excuse itself from further performance under a contract which has become unprofitable or difficult to perform.

However, the possibility of invoking this English law doctrine to bring a contract to an end is limited these days, due to the narrow ambit given to it by the English courts. Generally speaking, we are doubtful that a defence based on a plea of frustration would be likely to succeed.

There are two main reasons why the English courts are slow to recognise that a contract has been frustrated.

First, the courts are not prepared to allow parties to invoke the doctrine to escape from what has proved to be a bad commercial bargain. In the instance where the economic landscape has drastically changed – such as following a dramatic fall in the price of oil – it is usually the case that performance is not impossible. It is rather that it would be costlier to perform as required, and so less profitable. The doctrine of frustration will rarely operate to assist a party in such circumstances to avoid having to perform as required by a contract that it entered before the occurrence of the price fall.

Secondly, where commercial parties to a contract have included a *force majeure* clause within it which expressly applies to the relevant event or circumstances and provide for the consequences, the contract cannot be said to be frustrated because the parties simply have to look to the contract to determine the consequences of the event: there would be no need in such a case for the common law doctrine of frustration to operate. As mentioned above, it will often be the case that a *force majeure* provision will operate following the WHO's declaration of a pandemic and/or upon governments passing legislation to limit commercial activity in the face of the crisis. If so, then the doctrine of frustration will not operate to provide a party with relief from its contractual obligations agreed before the occurrence of the present crisis (since the *force majeure* provision will instead operate to addresses the consequences of the relevant event).

KEY POINTS

As in the case of *force majeure*, whether a contract has in law been frustrated will always have to be considered in light of the particular facts and circumstances of a case.

The English courts have been very reluctant to recognise mere inconvenience, hardship or financial loss involved in performing a contract as being sufficient to frustrate it.

Generally, therefore, it is extremely unlikely in our view that a party would be entitled to claim that its contract has been frustrated by the recent fall in the oil price so as to excuse further performance.

As to the COVID-19 pandemic, however, if neither the declaration of a pandemic by the WHO nor the government actions subsequent to this constitute events of *force majeure* under a contract, then consideration should be given to whether the doctrine of frustration might be effective to excuse further performance of the particular contract. This would be a fact dependent analysis requiring a very careful consideration of the impact of the current pandemic on the relevant obligations of the contract.

The English courts have been very reluctant to recognise mere inconvenience, hardship or financial loss involved in performing a contract as being sufficient to frustrate it.

(b) How might a sympathetic contractor agree to continue his existing contractual arrangements with a client on different terms?

Faced with a desire to maintain the prospect of better business again in the future post both the current public health crisis leading to global shutdowns of economic activity and upon improved prospects for the oil and gas industry, previous crises would tend to suggest that some commercial parties will choose to permit their struggling clients and other contractual counterparts to renegotiate existing contractual obligations. In effect, parties will make concessions concerning the terms governing their ongoing contractual relationships so as to maintain commercial relations with an eye to further and better commercial opportunities in better times in the future.

It may therefore be helpful to consider some of the issues which arise in this context.

i. What are "subject to contract" negotiations?

The first is to consider the employment of the words *"subject to contract"* in the course of any written or oral commercial discussions for the renegotiation of an existing contract[4].

In our experience, this phrase is often overlooked when negotiations are under way and yet it can be an extremely useful way of avoiding the risk that parties will be found to have agreed a contract even though they did not subjectively intend to do so or believe that they had done so (see above).

4
The use of the "subject to contract" prefix can equally be employed in the context of a negotiation for a new contract.

In short, the use of the expression *"subject to contract"* in respect of a negotiation will generally be regarded by the English courts or arbitral tribunal as denoting that the parties did not intend their negotiations, whether written or oral, to be effective to bring about a variation of their agreement or indeed a new agreement until they have reduced their agreement into writing and executed that written contract, at which stage the "subject" is lifted.

Accordingly, the use of the expression will tend to be effective to protect a party from the other party to negotiations later contending that a variation or indeed a new agreement had been reached even though the parties did not sign any such written agreement.

The more usual way, however, to avoid such consequences is through the inclusion of a "no oral modifications" clause in a contract governed by English law (i.e. a clause that provides that the terms of a contract cannot be varied orally by the parties but only by a written variation) since one of these will now, following an important recent Supreme Court case on such clauses, generally also be effective to preclude a party being inadvertently held to have orally agreed to a variation of an existing contract during discussions about varying the contract.

KEY POINTS

Do you have a "no oral modifications" clause in your contract? If so, then subject to its terms you will most likely be protected against inadvertently being deemed to have varied your contract in the course of oral discussions with your counterparty about varying its terms.

If you do not have such a clause in the contract, unintended consequences can be avoided by expressly describing as *"subject to contract"* any preliminary commercial discussions for a prospective contract, or indeed any negotiations about a potential variation to an existing contract undertaken to alleviate difficulties suffered by a party to that contract.

ii. How to effect an agreement to vary existing terms

As a matter of English law, parties are free by mutual agreement to vary the terms of a contract. Unless the existing contractual terms provide otherwise, such a variation may be made orally or in writing. However, contracts will often provide for the means by which the terms of the contract may be varied or altered. They will commonly stipulate that the variation must be effected in writing and that such variation should be signed by certain authorised persons on behalf of each party. Care should therefore be taken to closely follow any specified procedure.

Failing to do so will not *necessarily* invalidate any subsequent variation, but often it will do so (particularly if there is a clause providing that oral modifications are not effective and yet that is how the parties have sought to vary their contract). Even if not, significant legal costs may be incurred in resolving a dispute about this issue.

As an alternative to varying the terms of an existing contract, the parties may decide to release themselves from any further performance required under their existing contract so as to instead put in place a *new* contract. A contractor may, for example, wish to agree to allow a client or other counterparty to make a reduced regular payment. Implementing this by means of a new contract, in place of the old one, may be considered a cleaner method of defining the parties' new contractual obligations applicable in the new environment.

In such a case, the parties will wish to carefully document the client's (and indeed contractor's) release from those future contractual obligations which remain outstanding under the current contract. As a matter of English law, we would usually expect a client to require that its release by the contractor be effected by means of the parties executing a deed[5] as this dispenses with the necessity of the client proving that the client gave some consideration[6], in case there is any dispute later about the binding nature of what was agreed. The deed should be drafted to make it clear that its intent is to discharge the client (and indeed the contractor) from further obligations under the relevant contract. No particular form of words would be required to constitute a valid release, but care should be taken to ensure that the words are sufficiently clear to release the relevant obligations. The release would typically also be drafted so as to ensure that any claims which may have arisen under the parties' agreement to date are also settled and released so as to avoid the possibility of claims being brought later. In the event, therefore, that a contractor wishes to preserve known claims that he may have against a client, the contractor will wish to "carve out" these claims from the general release and settlement.

KEY POINTS

A variation of existing terms should be clearly agreed and expressed and should follow any requirements of the contract itself.

When executing an agreement to release the parties from their outstanding obligations remember to address potential accrued claims.

5
This is a particular type of legal agreement recognised under English law, which does not require "consideration" so as to be enforceable as a contract, but which requires certain formalities to beg met if it is to be legally effective.

6
As detailed elsewhere in this Guide, consideration is (broadly speaking) something of value which the law requires to be given for an agreement to be binding under English law.

c) Faced with an unsympathetic contractor, might the client nevertheless be entitled unilaterally to walk away from an existing contract without sanction (i.e. without the contractor having any redress)?

If a struggling client or other party to a contract is neither able to rely upon the doctrine of frustration nor to invoke an express provision under the contract (such as a force majeure provision) entitling it to terminate or to be excused from performance upon the occurrence of a particular event, that party may instead seek to contend that the contract has been brought to an end by the *contractor's* own breach of contract.

A breach on the part of a contractor may indeed provide an invaluable "get out" for a client looking to exit an unprofitable contract. Indeed, in the current extremely difficult times, we would expect cash-strapped clients and other commercial parties to be much more actively monitoring their counterpart's performance of ongoing contracts with a view to positively identifying valuable opportunities to exit costly contracts by contending that the other party's conduct has given rise to such a right of termination and exit[7].

KEY POINTS

Contractors in the present environment should therefore exercise great care to ensure that they comply fully with their own contractual obligations.

This will minimise the risk of "gifting" to a client a valuable right to walk away from a costly contract.

(d) What rights may arise in the event that a struggling client or other commercial party fails to perform its contractual obligations?

As a general proposition, any failure by a contractor's client or other contractual counterparty to perform as required by a contract will give rise to a cause of action entitling the contractor to claim damages in respect of his losses flowing from the breach.

In addition, a client or other counterparty's breach of contract may also entitle the contractor to treat itself as discharged from its future obligations under the contract (in effect, to exit the contract). In a case where such a right is exercised by the contractor, the contractor will also usually be entitled to bring a substantial damages claim for compensation to be paid by the client or other party in respect of the losses the contractor has suffered by the contract coming to an end.

For the reasons detailed below, however, great care must be taken by any contractor in determining whether such a right to treat a contract as discharged has arisen and, if it has, in any subsequent action taken, because very serious consequences can arise.

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A client may similarly be looking to identify a means of exiting an ongoing contract with a view to renegotiating the terms of that contract (for example, to secure a lower day rate) as the "price" for not exercising its right to terminate.

There below follows some headline information on this very important aspect of English contract law.

i. When will a contractor be entitled to treat a contract as discharged?

There are a number of instances in which a contractor would be entitled to treat a contract as discharged.

Commonly, the right will arise when a client or other counterparty fails to perform as required under a contract (that is to say breaches the contract) and such failure involves either:

i. a breach of a term of the contract which as a matter of law is regarded as a *condition* of the contract; or

ii. a breach of a term of the contract which is not regarded as a condition but rather what in law is known as an *innominate term* and the breach is so serious as to deprive the contractor of substantially the whole benefit of the contract which it was the intention of the parties (as expressed in the contract) the contractor should obtain as consideration for performing his further undertakings under the contract.

It is beyond the scope of this Guide to consider how English law goes about classifying the various terms of a contract (i.e. whether a term is a condition or an innominate term, or indeed only a "*warranty*" the breach of which cannot give rise to a right to treat the contract as discharged).

However, as indicated above, in the event of a serious breach of contract by a client or other counterparty, a contractor may well wish to seek legal assistance in determining what consequences may arise from such a breach, particularly given the risks identified below which may arise if prompt action is not taken in respect of such a breach.

An alternative circumstance in which a contractor may become entitled to treat a contract as being discharged arises when the client or other counterparty *renounces* the contract.

A renunciation results when one party to a contract by its words or conduct evinces an intention not to perform the contract, or expressly declares that it is unable or will be unable to perform its obligations under the contract in some essential respect. It can occur before or at the time fixed for performance.

In a case where a party expresses an intention *before* the time at which it is required to perform the contract that it will break it or act in such a way as to leave a reasonable person to conclude that it does not intend to fulfil its part of the bargain, this is said to constitute an "anticipatory breach of contract".

ii. What should a contractor do when a right to treat a contract as discharged may have arisen?

In any situation in which a contractor is faced with the possibility that a client or other contractual party may through its words or conduct have given rise to a right on the part of the contractor to treat the contract as discharged, great care must be taken.

As a priority, seek legal advice to determine that such a right has indeed in law arisen.

The risk is that if it has not arisen, and yet a contractor purports to exercise a right to treat the contract as discharged, this would be unlawful and would entitle the client or counterparty itself to treat the contract as discharged (and to bring a significant damages claim against the contractor).

Even if the contractor has obtained a right to treat the contract as discharged, great care must still be taken. This is because in a situation

where the right has arisen, the contractor will have to determine quickly whether he wishes to *"accept"* the discharge of the contract by the other's breach or to *"affirm"* the contract (i.e. to treat it as continuing). The consequences of such a decision are significant.

On the acceptance of a repudiatory breach, the contract will be treated as discharged, the parties will be excused from any further performance of their outstanding primary obligations under the contract and the contractor will instead be entitled to sue the client or other counterparty for such losses as the contractor has suffered (which might[8] include the profits that the contractor expected to make over what would have been the remainder of the life of the contract).

However, where a contract is affirmed, not only will the parties be required to continue to perform their outstanding contractual obligations, but the contractor's claim for damages in respect of the breach will be limited as compared to those available on the acceptance of the repudiatory breach. This is because, where the contract is affirmed, such damages claim as remains open to the contractor will be calculated having regard to the continuance of the contract.

KEY POINTS

A contractor must be very careful to ensure that it does not, when deciding whether to affirm the contract or to treat it as discharged, inadvertently take some step or by inaction affirm the contract.

If a contractor affirms the contract, any subsequent attempt to treat the contract as discharged may be a repudiatory breach of contract by the contractor, thereby entitling the client to treat the contract as discharged and claim damages from the contractor.

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This is subject to any applicable and effective exclusion/limitation of liability clauses in the contract

3. Conclusion

With, first, the latest dramatic fall in the oil price and now the unprecedented and immense consequences for not only the oil and gas industry but the world economy as a whole resulting from the COVID-19 pandemic, contractors in the oil and gas industry are operating in a commercial environment the likes of which has never been seen before in peacetime. They face huge uncertainty and risk in the market and contractors therefore need to be aware of the issues under English law that will commonly arise in the present circumstances as detailed in this Guide, and to be ready to act appropriately to avoid or to minimise these risks when they do. It is hoped that an astute contractor should be able to navigate its way round the challenges and avoid the worst consequences through a proper appraisal of the legal rights and duties existing in the changed circumstances.

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