English Law COVID-19 Q&A Series- Drilling Contracts

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Does the COVID-19 pandemic (or actions taken to counter the spread of COVID-19) constitute Force Majeure and is there any implied remedy (e.g. implied force majeure relief) arising as a result of the COVID-19 pandemic?

Under English law, unlike civil law systems, force majeure is neither defined nor automatically applicable to commercial contracts.

In order for a party to be excused for non-performance of a contractual obligation by relying on the force majeure principle, the contract must explicitly incorporate a force majeure clause which can either have a closed list providing for specific events that would constitute force majeure events, or a wider definition such as "events reasonably outside the parties' control".[1]

The COVID-19 outbreak may be caught by a number of different formulations. As drilling contracts are usually bespoke and heavily negotiated, it is not uncommon for force majeure clauses to be based on the LOGIC[2] form clause or the IADC[3] clause. However, these are often heavily amended. The LOGIC form clause provides a closed list of force majeure events and does not refer to epidemics or pandemics specifically, however, it does include changes in law and decrees by government as a force majeure event. In circumstances where new regulations and laws are being introduced for example to put into effect travel bans or restrictions, this could be applicable in the current situation. However, parties often add to this list and it is not uncommon for "effects of a pandemic" to be included, particularly after the outbreaks of MERS and SARS. You also sometimes see the addition of a catch-all provision to include any occurrence outside of the parties reasonable control. Such additions to the list means that the outbreak of COVID-19 would almost certainly be caught by the force majeure clause. The IADC standard clause is formulated somewhat wider, and includes epidemics, pandemics, Acts of God and acts of government, as well any act or cause that is reasonably beyond a party's control (other than financial distress or inability to pay debts when due) and therefore clauses based on this standard form are also likely to apply in the current circumstances.

As an alternative to the force majeure principle, a party may seek to rely upon the English law doctrine of frustration. Frustration requires the presence of a supervening unforeseen event through no fault of the parties that has occurred after the formation of the contract. For such an event to be a frustrating event it must also make performance of the contract illegal, impossible or radically different from what was anticipated by the parties. If a party establishes that its performance of the contract has been frustrated, then the contract is automatically terminated, and parties discharged from any future performance. The threshold to establish frustration is typically very high as it provides for the existence of strenuous circumstances and severe events that undermine the purpose of the contract.

In the context of a drilling contract that anticipates pandemics as a possible force majeure event and legislates for the impact of such an event, it is unlikely that frustration would be an available

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remedy.

If the COVID-19 pandemic (or actions taken to counter the spread of COVID-19) constitutes Force Majeure what might that mean for the Contractor and the Company?

Any party wishing to rely on a force majeure clause has to establish that (a) they have been prevented or delayed in performing a contractual obligation; and (b) the sole cause of such prevention or delay was the force majeure event. However, the practicalities of this is very different for Contractors and Companies

Contractor

Most of the obligations under a drilling contract are obligations for the contractor, for example there is likely to be an obligation to provide personnel for the performance of the services and there will be an obligation to perform drilling operations.

In light of the current travel restrictions and lockdowns that have been put in place it is possible if not likely that there will be an impact on the contractor's ability to provide services and man the unit as required under the contract.

Once you have established that a contractual obligation has indeed been delayed or prevented, it is important to show that the force majeure event is the only cause of such delay or impediment. This is well established in English law and the test is "but for" the force majeure event, would the party in question have been able to perform the obligation in accordance with the contract? For a Contractor, it is important to consider whether it would have been able to continue operating but for the COVID-19 outbreak. If, for example, it has suffered a catastrophic equipment failure that has also prevented performance, it may be prevented from claiming force majeure.

Company

For the oil company, there are fewer obligations and it may be difficult to see how an oil company has been prevented or delayed in performance. The following obligations are the most common:

1. Payment

2. Provision of transport to and from the area of operations

3. Provision of drilling programme[4]

Payment is often excluded from force majeure clauses, so in most circumstances an inability to pay invoices, financial distress or to pay its debt when due will not constitute force majeure. The more likely obligations therefore that an operator may be delayed or prevented from performing are transportation obligations and the provision of a drilling programme.

The same test for causation applies in respect of Operators as Contractors, however, as with the obligations, the practical implications are likely to be different. If, for example, the operator is looking to cut costs in light of the current oil price crash and is suspending operations in order to reduce discretionary spend, then "but for" the outbreak of COVID-19 it may still not have performed the contractual obligation and in those circumstances it is unlikely to be able to also claim force majeure under the drilling contract as the COVID-19 outbreak would be a competing cause not a sole cause for the delaying or preventing contractual performance.

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Are there wider practical considerations for CONTRACTOR in the face of the COVID-19 pandemic?

Contractors are having to overcome a number of hurdles and adapt their operations to continue performing services in accordance with their contracts and their legal and regulatory obligations.

Consider, for instance, a Contractor's obligation is to provide personnel to operate a drilling rig. As governments close borders, airlines cancel commercial flights, public transportation operations within certain countries are drastically reduced and hotels closed down, Contractors are facing challenges to make sure workers (particularly the ones living outside the country of operations) are available at the boarding area in time for their shift. In theory crew changes concerns could be reduced with the extension of shifts but the applicability of any such measure is subject to the employment legislation of the relevant country of operations and there is usually a maximum number of days a person can remain onboard.

Another key point is that Contractors are required to maintain high standards of health and safety in their operations and the wellbeing of their employees. Contractors may have to adopt procedures and protocols to mitigate the risk of transmission onboard to as low as reasonably practical, to isolate or evacuate sick employees in the event of COVID-19 suspected cases or, ultimately, to shut down operations if necessary.

It is worth noting that industry associations across the globe are playing a pivotal role in making sure governments safeguard maintenance of the oil and gas industry activities and recognise their employees as key workers. Contractors, in some cases with the help of said associations, have also reached special agreements with the private sector, such as hotels, taxi and helicopter providers, to ensure accommodation and transport to and from the area of operations are available amid the crisis.

If, despite its efforts, a Contractor is unable to perform the services due to the COVID-19 pandemics and the measures that are being put in place to tackle the spread of the virus, Contractor will have to assess if the current situation qualifies as a force majeure event and the procedures it will have to follow to make valid and effective force majeure claims under each relevant drilling contract. It is of utmost importance to analyse the contract provisions to understand when a force majeure notification is required and, particularly in cases where a claim for force majeure is conditional on the correct notice being given, what its contents should be, to whom it should be addressed and where and how it should be delivered. There is no one size fits all and a bespoke notification will have to be drafted and delivered pursuant to the specific terms of each drilling contract a Contractor is unable to perform.

Are there wider practical considerations for COMPANY in the face of the COVID-19 pandemic?

For the Company, there are a myriad of other practical considerations that will need to be taken into account in the face of the ongoing COVID-19 pandemic.

HSE

The HSE has carried out a short pause on its offshore oil and gas and onshore chemical, explosives and microbiological industry inspection activities to give duty holders time to overcome various immediate pressures and challenges.

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It has also published some general guidance relevant to all employers relating to, for instance, the provision and use of personal protective equipment (PPE) at work, health and safety responsibilities for home workers as well as the provision of first aid cover and qualifications. It is therefore important for the Company to ensure it is following, and is adhering to, the latest guidance published by the UK government to address health and safety concerns.

Quarantine and self-isolation procedures

For any of the Company's offshore personnel, it will need to stay up-to-date with the guidelines on quarantine and self-isolation procedures and requirements. For instance, Oil & Gas UK ("**OGUK**") has published a "COVID-19: Movement of Passengers Flowchart" (accessible on its website) which sets out the procedures that should be followed to determine whether a suspected COVID-19 case (including those that have been in close contact) should be isolated onshore or offshore. In the event that transportation onshore is required, there are also protocols that need to be followed relating to helicopter travel (e.g. operational procedures, arrivals and departure protocols, and the transfer of passengers). As typically the Company is required to provide transportation to and from the drilling unit, the responsibility for any evacuation measures will most likely fall within the Company's remit. It is therefore important for the Company to be familiar with all relevant protocols to ensure proper implementation.

OGUK has teamed up with Step Change in Safety to launch a dedicated online hub with guidance, videos and FAQs. All COVID-19 related videos can be viewed here.

Step-in rights

Typically, the Company of a drilling contract may have a right of termination if the event of force majeure has gone on beyond a specified time. Although more likely to be relevant under any facility/loan agreements that have been entered into, depending on the way the drilling contract was negotiated and drafted, the right of termination may also be linked to step-in rights. The Company should therefore review the relevant provisions to check if and when step-in rights may arise, as this may give the Company the flexibility it needs to ensure continuity of performance during the period of force majeure.

Termination for convenience

Given that usually most drilling contracts will contain relatively generous termination for convenience provisions in favour of the Company (i.e. a clause that allows a party to terminate the agreement without a specific reason for doing so, such as a default or breach of the contract), the Company should check if such a right exists under the relevant drilling contracts it has entered into, as this may be an alternative means of putting an end to the contract (if required), especially if force majeure may not be available.

If a drilling contract is entered into now will FM apply immediately upon commencement of the contract?

Common to most force majeure provisions is the requirement for the party claiming a force majeure event to demonstrate that such event was not reasonably foreseeable by the parties when the contract was signed, and the effects therefore could not be avoided. Although the relationship between prior knowledge and the ability to claim force majeure is not definitive, it will be difficult for a contractor of a drilling contract, for instance, to argue that it was not reasonably foreseeable that

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the impact of the ongoing COVID-19 pandemic would affect its performance at the time of entering into the contract.

It would therefore be prudent for parties entering into impending drilling contracts to factor in any likely delays to the works, as well as to consider any steps that could or may be taken to find alternative solutions and to mitigate losses, as a result of potential impacts of the COVID-19 pandemic.

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[1] Although such clauses still often include a non-exhaustive list of events by way of example.

[2] Mobile Drilling Rig Contract, 1997 Form.

[3] International Offshore Daywork Drilling Contract, 2007 Form. Note that comments under this Q&A apply if parties have elected England and Wales as the Governing Law of the relevant contract.

[4] This was the obligation relied upon in Seadrill Ghana v Tullow Ghana [2018], Teare J accepted, without considering in detail, that the obligation on Tullow to provide Seadrill with a drilling programme prior to commencement of drilling was an obligation that was capable of being delayed or prevented in the context of force majeure.

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