

Construction: How to Save a Contract

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There were a number of news reports late last year indicating that shipyards, including the major Korean shipyards, had entered into agreements with buyers to delay delivery of offshore units and related vessels. Agreements by which the delivery date of a unit is postponed by mutual agreement are known as extension agreements.

Such extension agreements can be a pragmatic solution in a market where new offshore oil and gas projects have been cancelled or delayed, or where units are without employment due to a low oil price. It is an increasingly common strategy for saving existing offshore newbuilding projects. The hope is that by the time the unit is delivered, the offshore market will have improved and that the buyer will have been able to secure employment for the unit.

Extension agreements, however, raise a number of new issues that are unlikely to be addressed in the construction contract. This is because an offshore construction contract assumes that the builder will deliver the unit as soon as it can after completing the unit. That assumption no longer applies if there is an extension agreement.

Programme for completion

The construction contract will normally contain a programme providing for the shipyard to continually progress the work until completion and then carry out the tests and trials as soon as possible after completion or, potentially, as soon as possible after completion of specific elements of the work necessary to enable tests and trials to take place, notwithstanding that there is still on-going work.

This standard approach to tests and trials has two implications for the buyer during the construction contract.

Firstly, the buyer will have a supervision team at the shipyard throughout the project to supervise the work and witness the tests and trials, although the make-up of the supervision team will vary depending on the stage of the project.

Secondly, the buyer can assume that the results of the tests and trials will still be applicable on delivery. Indeed, in most offshore construction contracts, at the end of sea trials, the buyer is required to elect whether they accept or reject the unit. If the buyer accepts the unit, the buyer is not subsequently entitled to refuse delivery, provided that the shipyard complies with its other obligations under the construction contract.

If the delivery date is extended, the parties should agree a new programme for completion of the work and carrying out tests and trials.

If the shipyard is entitled to complete the work slowly during the extension period, then the buyer will have to maintain a supervision team at the yard for the full extension period, which may substantially increase the buyer's supervision costs.

The parties should also agree precisely when during the extension period the tests and trials are to be carried out. If these tests are to be carried out substantially before the new delivery date, the buyer may be concerned that the results of the tests and trials may not still be applicable by the delivery date.

Furthermore, if the buyer is required to accept or reject the unit upon completion of these tests and trials, the buyer may also be concerned that it is committing to accept that the unit complies with the contract and the specification at a point in time considerably earlier than the new delivery date.

If, however, the tests and trials are deferred until shortly before the new delivery date, there is a risk that defects will be discovered at that stage, which may cause further delay to the new delivery date.

Maintaining the unit

The parties will need to agree how the unit will be maintained during the extension period, and by whom. Although the shipyard may be an expert in constructing offshore units, it may not have the necessary expertise to maintain them, which is likely to be within the expertise of the buyer as an operator.

In addition, there are of course different ways to maintain an offshore unit, in particular whether in warm stack or cold stack, which has significant implications for cost and for the condition of the equipment on the unit.

Depending of course on the period of the extension and how the unit is maintained, there may be some wear and tear and deterioration in the condition of the unit during the extension period. An offshore construction contract normally does not allow for any such deterioration, and the parties will need to consider whether it is necessary to amend the contractual provisions relating to the condition of the unit at delivery.

Finally, the parties should agree where the unit is to be located during the extension period, for example at quayside or at anchorage. As the buyer is likely to have personnel on board the unit during the extension period and will probably want to carry out some work on equipment during this time, the location of the unit may significantly affect the time and cost to the buyer of transporting personnel to the unit.

The refund guarantee

The buyer is normally provided with a refund guarantee from a bank securing repayment of the pre-delivery instalments of the contract price, paid by the buyer to the shipyard before delivery. This is a key document from the buyer's perspective. Without it, if the buyer has to terminate the construction contract and claim repayment of the pre-delivery instalments of the contract price, the buyer will be an unsecured creditor of the shipyard and will, if necessary, have to enforce its claim against the assets of the shipyard. These are likely to be located in the jurisdiction in which the shipyard is based.

It is essential for the buyer to ensure that the refund guarantee is not only extended to cover the extension period, but is also not invalidated by the deferral of the delivery date. It is also important that any additional sums paid by the buyer to the shipyard before delivery are covered by the refund guarantee.

While the commercial attraction of extension agreements in the current climate is clear, it is important that the parties appreciate that, by substantially extending the delivery date, the construction contract is being transformed in some key respects into a somewhat different animal.

Covered here are just some examples of the issues that the parties need to consider when agreeing an extension agreement. This of course is not an exhaustive list and there may be further issues that arise as a result of the specific terms of the construction contract.

What is however hopefully demonstrated here is how unwise it is for the parties simply to amend the delivery date and the contract price in the construction contract, and to assume that the terms of the construction contract will adequately address the extension period. Such an approach may not provide a solution for the project, but simply defer a substantial and messy dispute until a later date.

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