

Presentation to IADC Contracts Committee

**Negotiating aims for drilling contractors following
Transocean Drilling UK Limited v Providence
Resources plc [2014] EWHC 4260 (Comm.)
“Arctic III”**

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Introduction (1)

1. English law decisions on drilling contracts are few and far between
2. Industry therefore takes note when a judgment appears – the “Chris Chenery” (1987), “The Ekha” (2010) and the “Arctic III” (2014)
3. What is the overall theme of these cases? You have to use “clear words” to describe precisely what you intend in your contracting arrangements
4. Judges often say this would have been “very easy” for the parties to do
5. Drilling contractors facing extremely difficult market conditions so “clear words” may be difficult to achieve
6. Our aim is to show negotiating best practice



Introduction (2)

The “Chris Chenery” (1987)

“(1) Put bluntly [parties] are unlikely to contract to pay something for nothing, particularly if the failure to perform by the payee is due to his own negligence or default.

(2) ... if the stipulation is to make continuing and regular payments throughout a defined period of time whether or not the work is being performed, the services being rendered or materials, equipment and supplies being furnished, one would expect to find an express term which provided for such payments related to the period during which the payments were to continue, rather than one related to the work, etc. for which the payment is to be made.

(3) ...an obligation to pay in the absence of work being performed, etc. will only be inferred if there is no other reasonable alternative.

(4) In construing clauses...providing for payments for work performed, services rendered or materials, equipment and supplies furnished, express words...are required before the scope of such clauses can be extended to exclude rights and liabilities arising under other clauses ...”



Introduction (3)

“The Ekha” (2010)

“I also have some reservations about having regard to...attitudes generally prevailing in the offshore drilling industry towards risk allocation and the means of providing for it...I do not accept...that one can properly approach a contract of this kind on the assumption that the parties were seeking to allocate the burdens of loss and damage occurring in the course of operations solely by means of risk allocation provisions rather than by defining the scope of their respective obligations.”

...

“If [the parties] had intended that the operator should be unable to recover hire under any circumstances, it would not have been difficult to make that clear, but they have not done so.”



Arctic III – Background

- Transocean (the claimant) chartered the “Arctic III” semi-submersible drilling rig to Providence (the defendant) to drill an appraisal well off the south coast of Ireland
- Delays occurred in operations due to issues with the rig’s BOP which required repairs
- Transocean sought to apply the contractual dayrates during the disputed period i.e. the daily operating rate, the standby rates, the repair rate and the waiting on weather rate
- Providence disputed liability, claiming the delay was caused by Transocean’s breach of contract and/or misrepresentation and it counterclaimed for its marine spread costs (cost of personnel, equipment and third party services) wasted as a result of the delay



Arctic III – Issues

The Court had to determine:

1. how the remuneration provisions in the contract were to be construed
2. whether Transocean was in breach of its obligation to maintain the rig and its equipment
3. if Transocean was in breach, what proportion of Transocean's claim and Providence's counterclaim was recoverable
4. whether Providence's counterclaim for spread costs was excluded by the indemnity provisions in the contract
5. whether Providence's claims for misrepresentation succeeded



Arctic III – Judgment (1)

1. The court held that none of the day rates applied when operations had ceased due to Transocean's fault
2. Three principles emerged:
 - (a) the general principles governing contracts for goods and services applied equally to drilling contracts
 - (b) the provisions provided that Providence was obligated to remunerate Transocean in return for work performed rather than by reference to a specified period and this indicated that the right of abatement was preserved
 - (c) the contract did not provide, expressly or impliedly, that Transocean would be paid a day rate if the Rig was not operating due to Transocean's breach



Arctic III – Judgment (2)

3. Transocean was in breach of the drilling contract in not maintaining the Rig and its equipment
4. As Transocean was relying on an exclusion clause, its provisions were construed strictly against Transocean
5. Parties to commercial contracts are entitled to apportion risk of loss as they see fit but in this contract there was no provision which excluded Providence's spread costs
6. As Transocean was held to have breached the contract, the court did not consider the misrepresentation claim in detail as the court's decision could not affect the result



Arctic III – Potential problems for drilling contractors (1)

1. Contractor remuneration schedule was found not to contain a “complete code” for all liability of Contractor for breach or negligence
2. The contractual indemnity and exclusion provisions did not effectively exclude Contractor’s liability for the Operator’s marine spread costs
3. Contractor was found to have an absolute obligation to maintain the rig and its equipment at all times throughout the charter
4. The contractual provisions did not preclude a claim for misrepresentation



Arctic III – Potential problems for drilling contractors (2)





Arctic III – Potential problems for drilling contractors (3)

1. The decision was made in relation to a bespoke contract – although Section II (General Conditions) was based on CRINE/LOGIC terms, this was an amended or negotiated form.
2. The decision was heavily influenced by facts of case
3. Aspects of the decision are being appealed and the question of whether Transocean will receive permission to appeal should be resolved shortly
4. If permission to appeal is not granted, or the appeal is unsuccessful, Popplewell J's decision is not binding on another English High Court judge and will only be considered to be of persuasive effect in High Court proceedings relating to similar contractual language. Subject to the outcome of the appeal, the decision will be binding upon London arbitration tribunals
5. But most importantly – these problems can be addressed by including appropriate language in your contracts



Issue 1

Contractor's remuneration



Contractor's remuneration (1)

"Arctic III" LOGIC Form (amended)

Section II - Clause 13.1 - Terms of Payment

For the **performance and completion of the Work**, [Provident] shall pay or cause to be paid to [Transocean] the amounts provided in Section III-Remuneration at the times and in the manner specified in Section III and this clause.

Section III – Remuneration

Subject to the terms of this Contract and **as full compensation for performing the scope of work** and for complying with the obligations of the Contract, [Provident] shall pay [Transocean] in accordance with the format outlined hereunder.

Only one dayrate shall apply at any one time. Determination of the rate to apply shall be by mutual agreement, having due regard to the circumstances prevailing and the operations intended to be covered by the following rates.



Contractor's remuneration(2)

"Arctic III" LOGIC Form (amended)

Repair Rate

Except as otherwise provided, the Repair Rate will apply in the event of **any failure of [Transocean's] equipment** (including **without limitation**, non-routine inspection, repair and replacement which results in shutdown of operations under this Contract) including the time up to recommencement of [Providence's] operations at the same point (including any trip time e.g. "drill to drill") as when the failure occurred excluding any period when the failure has been remedied by operations but operations cannot proceed due to adverse weather or sea conditions, or while waiting on [Providence's] instructions, materials or services or any period of time when the failure or repair has been caused due to an act or omission of any member of Company Group or a Force Majeure Event.

(See also Clauses 3.2 (Operating Rate), 3.5 (Standby Rate) and 3.11 (WOW Rate))



Contractor's remuneration (3)

The Court's Finding – Application of dayrates

1. Transocean's arguments were rejected by the Judge
2. The Judge found that there is nothing in the wording of the relevant clauses which makes it clear that Transocean was to be paid at the applicable dayrates when the rig was not performing the work required due to Transocean's breach
3. The words "any failure" in the Repair Rate clause are not wide enough to evidence a clear intention to pay for work not performed, to give up a right of abatement, or to accept an obligation to pay for the consequences of Transocean's (alleged) negligence
4. The fact that only one dayrate is said to apply at any one time also does not assist Transocean because dayrate clauses are to be interpreted in accordance with relevant English principles of construction



Contractor's remuneration (4)

The Court's Finding – English law principles of construction

1. Unless a contract contains clear language to the contrary, it will not be construed as enabling a party to take advantage of his own breach of contract (*Alghussein v Eton College* [1988] 1 WLR 587)
2. Where an exemption clause is capable of applying to negligent and non-negligent breaches, which are not fanciful, one should approach a clause on the basis that it was not intended to exclude liability for negligence unless the clause made it clear
(*Canada Steamship Lines v The King* [1952] AC 192)
3. In respect of abatement (a remedy which enables a person who contracts for work to defend a claim for remuneration by showing how much less the services are worth by reason of the other party's breach) – in construing a contract for services, one starts with the presumption that neither party intends to abandon any remedies for its breach arising by operation of law. Clear express words must be used in order to rebut this presumption.
(*Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol)* [1974] AC 689)



Contractor's remuneration (5)

IADC Form (2007 edition) – Clause 701

Operator shall pay to Contractor the amounts from time to time due, calculated to the nearest hour, according to the rates herein set forth and in accordance with the other provisions hereof, **notwithstanding any breach of representation or warranty, either expressed or implied, or the negligence or fault of any degree or character** of Contractor, Contractor's Personnel, its subcontractors, consultants, agents of servants, **including sole, concurrent or gross negligence**, either active or passive, latent defects or unseaworthiness of any vessel or vessels, including the Drilling Unit (whether or not pre-existing), and any liability based on any theory of tort, breach of contract, breach of duty, (whether statutory, contractual or otherwise), regulatory or statutory liability, or strict liability, including defect or ruin or premises either latent or patent.



Contractor's remuneration (6)

1. The IADC clause is clearly superior to the clause set out in the "Arctic III" contract in appearing to provide for contractor to be paid and to retain dayrates regardless of fault
2. However, Mr Justice Flaux found in "*The Ekah*" that Clause 701 in the IADC Form was no more than a "*pay now, dispute later*" clause:

"As a matter of well-established principle, [Gazprom] would have been able to recover that wasted hire as damages for breach of contract, unless there were clear and unequivocal words in the contract to the effect that the right to hire was absolute and there would be no entitlement to recover the wasted hire as damages."

3. What this means in practice for parties operating under the IADC form using English law is that the operator would have to pay all day rates in full but could potentially claim these back in full as damages
4. In both cases, the English court was not prepared to uphold the premise that the operator would be considered adequately compensated for downtime by a reduction in rate



Contractor's remuneration – Negotiating aims

To address the issues arising from the “Arctic III” and the decisions that have preceded it, drilling contractors should seek to include “clear words” to the following effect in their contracts:

1. Contractor is entitled to be paid and to retain the applicable dayrate (as determined by the contractual provisions/mutual agreement) even when the rig is not performing due to Contractor’s breach or negligence;
2. Contractor’s entitlement to hire is absolute and Company has no entitlement to recover wasted hire as damages;
3. Company waives any right of abatement;
4. Company’s sole remedy for breach of any duty (contractual, statutory or otherwise) or negligence is the application of one of the applicable reduced rates under the contract.



Issue 2

Contractor's liability for marine spread costs



Consequential loss (1)

Providence's claimed losses arising from Transocean's breach of contract - wasted spread costs due to period of delay - \$10 million

"Arctic III" LOGIC Form (amended)

The relevant clause - Clause 20

... loss or deferment of production, loss of product, **loss of use (including, without limitation, loss of use or the cost of use of property, equipment, materials and services including without limitation, those provided by contractors or subcontractors of every tier or by third parties)**, loss of business and business interruption, loss of revenue (which for the avoidance of doubt shall not include payments due to [Transocean] by way of remuneration under this CONTRACT), loss of profit or anticipated profit, ...



Consequential loss (2)

The court's finding – Loss of use:

"In that context "loss of use" is more naturally to be read as connoting the **loss of expected profit or benefit to be derived from the use of property or equipment.**

This construction gains strength and colour, by application of the *eiusdem generis* principle, from the other identified types of loss. The body of the subparagraph identifies seven other types of loss apart from loss of use, namely (i) loss or deferment of production (ii) loss of product (iii) loss of business and interruption (iv) loss of revenue, which is defined to exclude for the avoidance of doubt remuneration due to Transocean (v) loss of profit or anticipated profit (vi) loss/deferral of drilling rights and (vii) loss/restriction/forfeiture of licence, concession or field interests. Subject to possible debate in the case of loss of product, these are all losses of income or benefit. This is consistent with the approach...in *Ease Faith Ltd v Leonis Marine Management Ltd [2006]* ...in which ...[the judge] determined that an exclusion of loss of profit by a tug or tow did not cover loss comprising diminution of the price when construed *eiusdem generis* with "loss of use" and "loss of production" which were directed to future use of the tug or tow."



Consequential loss (3)

The Court's finding - Cost of use

“Cost of use.....” is an example given within the parenthesis of a loss of use. **It covers the cost of hiring in equipment or services, or replacing property the benefit of which has been lost, in order to mitigate the loss of benefit.** It has no application to the spread costs where the costs are for equipment and services which were provided. Providence did not lose the use of that equipment or those services, which remained available to it, which is why Providence incurred wasted expenditure in paying for them.”



Consequential loss (4)

The “Black Hole” problem

“If the clause were to be construed as Transocean contends, the exclusion would cover all losses which Providence might conceivably suffer by way of damages for which Transocean would otherwise be liable... [Transocean’s barrister] could not identify any head of loss which Providence might suffer for which Transocean would be liable as damages for breach of its contractual obligations, outside the specific indemnities in clause 18, if consequential loss were to be construed as widely as he suggested. This is a clear indication that it cannot bear such a construction. The Court will not readily construe a clause as having this effect because to do so is to render the primary performance obligations in the contract effectively devoid of contractual content, there being no sanction for non-performance...”



Consequential loss (5)

LOGIC Form – Clause 20

CONSEQUENTIAL LOSS

For the purposes of this Clause 20 the expression "Consequential Loss" shall mean indirect losses and/ or loss of production, loss of product, **loss of use** and loss of revenue, profit or anticipated profit.

Notwithstanding any provision to the contrary elsewhere in the CONTRACT and except to the extent of any agreed liquidated damages or any termination remuneration payable to CONTRACTOR and provided for in the CONTRACT, the COMPANY shall save, indemnify, defend and hold harmless the CONTRACTOR GROUP from the COMPANY GROUP's own Consequential Loss and the CONTRACTOR shall save, indemnify, defend and hold harmless the COMPANY GROUP from the CONTRACTOR GROUP's own Consequential Loss.



Consequential loss (6)

IADC Form (2007 edition), Clause 909

Consequential Damages

Subject to and without affecting the provisions of this Contract regarding the payment rights and obligations of the parties or the risk of loss, release and indemnity rights and obligations of the parties, each party shall at all times be responsible for and hold harmless and indemnify the other party from and against its own special, indirect or consequential damages, and the parties agree that special, indirect or consequential damages shall, notwithstanding any interpretation under applicable law to the contrary, be deemed to include, whether direct or indirect, without limitation, the following: loss of profit or revenue; *costs and expenses resulting from business interruptions*; loss of or delay in production; loss of or damage to the leasehold, concession, production sharing contract or other similar rights; *loss of or delay in drilling or operating rights*; **cost of or loss of use of property, equipment, materials and services, including without limitation those provided by contractors or subcontractors of every tier or by third parties.**



Consequential loss – Negotiating aims

Key drafting considerations:

1. Expressly exclude spread costs during downtime of the rig for any reason
2. State that the clause applies in all circumstances, including Contractor's breach of contract, negligence or breach of duty etc.
3. Words need to be absolutely clear because of the "Black Hole" problem
4. If (1) and (2) are not possible, or to counter the "Black Hole" problem, consider providing for limited daily liquidated damages up to an overall cap for breakdown or other downtime for Contractor's negligence or breach of contract etc.



Issue 3

Contractor's duty to maintain



Contractor's duty to maintain (1)

"Arctic III" LOGIC Form (amended)

Standard of maintenance at Commencement Date

Clause 4.1

"On Commencement Date... [Transocean] shall provide the Drilling Unit fully equipped... **the Drilling Unit shall be adequate to conduct the Work...** contemplated by this Contract.

Standard of maintenance during contractual operations

Clause 4.1

The Drilling Unit and all other equipment, materials and supplies hereinafter specified as being provided by [Transocean] shall be in **good working condition** and together with the personnel, shall be **provided and maintained** by [Transocean].

[Transocean] shall carry out all of its obligations under the Contract and shall execute the Work with **all due care and diligence** and with the **skill to be expected of a reputable contractor** experienced in the types of work to be carried out under the Contract."



Contractor's duty to maintain (2)

Standard of maintenance during contractual operations (cont.)

Clause 5.10

[Transocean] shall install, operate, test, repair and maintain its well control equipment, **in good condition at all times** and shall use all reasonable means to control and prevent fires and blowouts and to protect the hole.

Clause 7

[Transocean] shall ensure that all tools, equipment, facilities and other items for use by [Transocean] in the performance of the Work, however and by whoever provided, are **maintained in a safe sound and proper condition**, are certified and **are capable of performing the function for which they are intended.**"



Contractor's duty to maintain (3)

The Court's finding

Standard of maintenance at Commencement Date

1. The Court held that the quality obligations assumed by Transocean in relation to the Rig and its equipment were absolute
2. Transocean's obligation was to maintain the Rig as "adequate to conduct the work"
3. Such obligations were therefore not satisfied merely by the exercise of "due diligence" or "reasonable care"



Contractor's duty to maintain (4)

The Court's finding

Standard of maintenance at Commencement Date (cont).

“A Rig which at the time of delivery has equipment in such a state that it is susceptible to breakdown or malfunction during normal use in the projected well operation is not then in good working condition or in a state which is “adequate to conduct the Work. The effect of this warranty is that it will be broken if there is a subsequent breakdown or malfunction of the Rig during the projected work which is not caused by some abnormal operation of the rig or some supervening causative event.”



Contractor's duty to maintain (5)

The Court's finding

Standard of maintenance during contractual operations

1. Clauses 4, 5.10 and 7 make clear that Transocean had a continuing obligation to ensure that the Rig and its equipment were capable of conducting the work
2. The Judge therefore rejected Transocean's argument that they were only obliged to exercise due diligence or reasonable care following the commencement date
3. He found that the language of these clauses is that of "...achieving a stated result, not of following a due diligence process in order to achieve it."
4. The Judge noted that where the parties wished to identify a due diligence obligation, they did so in clear terms. Such clear terms were not evident in Clauses 4, 5.10 or 7



Contractor's duty to maintain (6)

IADC Form (2007 edition)

Maintain and Repair Equipment (Clause 403)

Contractor shall, subject to Paragraph 901 and Appendix D, **be responsible for all maintenance and repair of all Contractor's Items** and shall provide all spare parts and materials required therefor. Contractor shall, if requested by Operator, also maintain or repair any of Operators' Items on board the Drilling Unit which Contractor is qualified to and can maintain or repair Contractor's normal component of personnel on board the Drilling Unit, provided, however, that Operator shall at its cost provide all spare parts and materials required to maintain or repair Operator's Items, and the basis responsibility and liability for furnishing and maintaining such items shall remain with Operator.

Well Control Equipment (Clause 509)

Subject to Paragraph 706 and Article IX, Contractor shall **maintain** its well control equipment... **in good condition** at all times and **shall use all reasonable means** to prevent and control fires and blowouts and to protect the hole.



Contractor's duty to maintain – Negotiating aims

Key drafting considerations:

1. avoid representations or undertakings to the effect that the equipment will remain in a certain condition at all times throughout the contract period;
2. avoid terms that undertake without qualification that the rig and equipment will operate without interruption or continuously at all times;
3. provide for rig acceptance prior to the commencement date based on clearly defined objective criteria set out in a schedule to the contract;
4. provide that on and following acceptance of the rig, and for the duration of the contract, Contractor shall exercise due diligence and reasonable care to maintain the drilling rig and its equipment to the standard of a “reasonable and prudent drilling contractor”;
5. alternatively, aim for a standard of maintenance and repair that is similar to time charters of ships e.g. an express obligation to take reasonable steps within a reasonable time when the rig or its equipment ceases to be efficient or in good working order.



Issue 4

Contractor's liability for misrepresentation



Misrepresentation (1)

1. Providence claimed its wasted spread costs in the alternative as damages for misrepresentation
2. Providence were unable to demonstrate reliance, so claim for misrepresentation failed
3. Contract did not exclude claims for misrepresentation



Misrepresentation (2)

**AXA Sun Life Services Plc v Campbell Martin Ltd and others [2011]
EWCA Civ 133**

Clause 24

This Agreement and the Schedules and documents referred to herein constitute the entire agreement and understanding between you and us in relation to the subject matter thereof. Without prejudice to any variation as provided in clause 1.1, this Agreement shall supersede any prior promises, agreements, representations, undertakings or implications whether made orally or in writing between you and us relating to the subject matter of this Agreement...



Misrepresentation (3)

AXA Sun Life Services Plc v Campbell Martin Ltd and others [2011] EWCA Civ 133

“In my judgment, this jurisprudence confirms my provisional conclusion on the wording of Clause 24. No doubt all such cases are only authority for each clause's particular wording: nevertheless it seems to me that there are certain themes which deserve recognition. Among them is that the **exclusion of liability for misrepresentation has to be clearly stated**. It can be done by clauses which state the parties' agreement that there have been no representations made; or that there has been no reliance on any representations; or by an express exclusion of liability for misrepresentation. However, save in such contexts, and **particularly where the word “representations” takes its place alongside other words expressive of contractual obligation, talk of the parties' contract superseding such prior agreement will not by itself absolve a party of misrepresentation where its ingredients can be proved.**”



Misrepresentation (4)

LOGIC /CRINE Form – Clause 26.6

Entire Agreement

The CONTRACT constitutes the entire agreement between the parties hereto with respect to the WORK **and supersedes all prior negotiations, representations or agreements related to the CONTRACT**, either written or oral. No amendments to the CONTRACT shall be effective unless evidenced in writing and signed by the parties to the CONTRACT.



Misrepresentation (5)

IADC Form – Clause 309

Entire Agreement

This Contract constitutes the full understanding of the parties, and a complete and exclusive statement of the terms of their agreement, and shall exclusively control and govern all work performed hereunder. **All representations, offers, and undertakings of the parties made prior to the effective date hereof, whether oral or in writing, are merged herein**, and no other contracts, agreements or work orders, executed prior to the execution of this Contract, shall in any way modify, amend, alter or change any of the terms or conditions set out herein.



Misrepresentation – Negotiating aims

To address the issues arising from the “Arctic III”, drilling contractors should seek to include “clear words” to the following effect in their contracts:

1. expressly exclude liability for misrepresentation, whether made innocently or negligently
2. state neither party has relied on any representation or statement not set out in the contract
3. state that the parties’ remedies in respect of any statement or representation set out in the contract shall be limited to breach of contract and neither party shall have any claim for innocent or negligent misrepresentation



Some “clear words” to conclude...

1. It is very important to use clear express words if you want to limit the other party's rights at law
2. English courts are extremely reluctant to reward a party in breach
3. It is better to provide a remedy for breach rather than risk the court determining what sanction for breach should be
4. *And finally*, don't be discouraged from contracting under English law in your offshore contracts – for offshore contractors, the ability to allocate knock for knock indemnities regardless of the degree of default is hugely advantageous

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