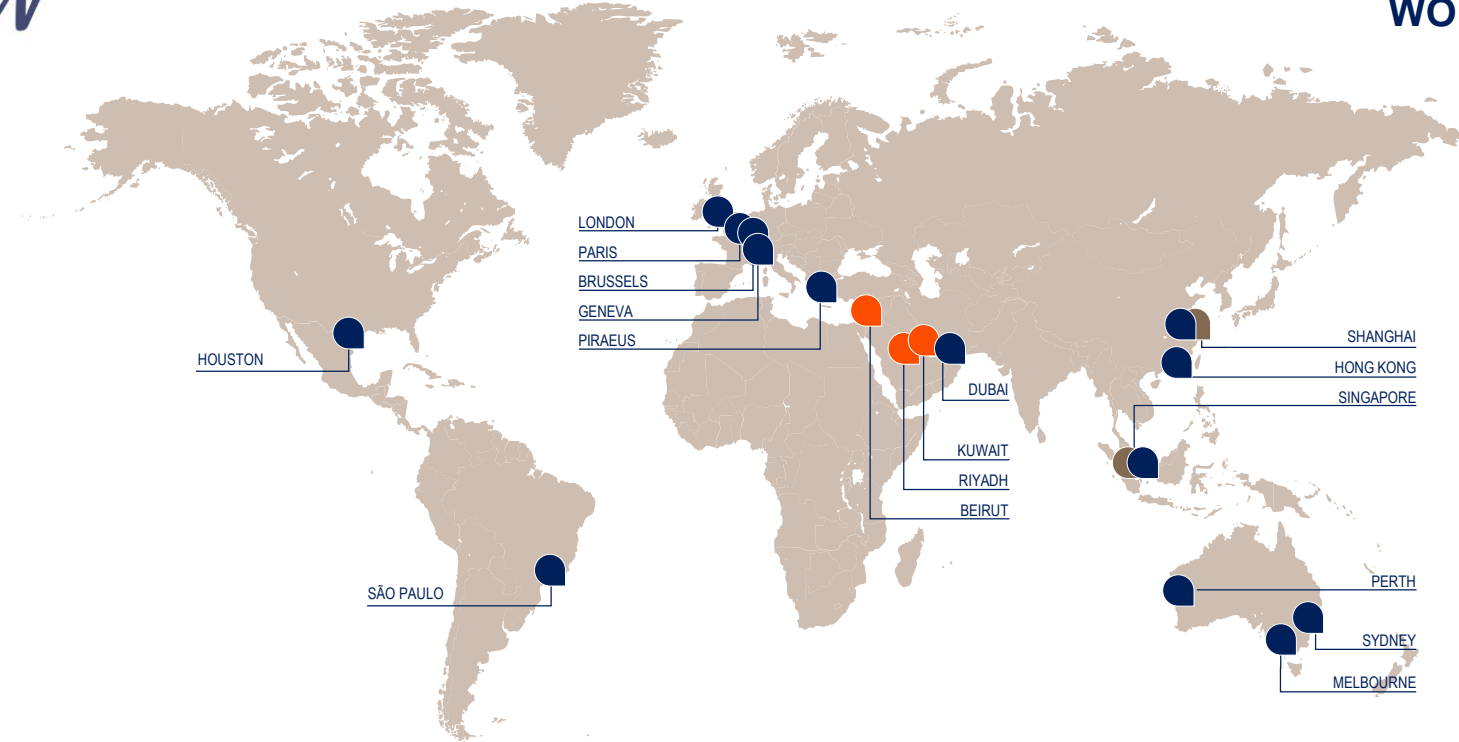


# Rigs Emerging from Stack: Risks and Exposures

A photograph of an offshore oil rig at sea during a dramatic sunset. The sky is filled with horizontal bands of orange, red, and purple clouds, transitioning to a deep blue at the top. The rig is illuminated with lights, appearing as a bright silhouette against the colorful horizon. The sea is dark and calm.

**Glenn Legge**  
**Chanaka Kumarasinghe**  
**Jeanie Goodwin**

**Presentation to IADC Contracts Committee**  
**10 May 2018 - Houston, Texas**



-  HFW OFFICE
-  ASSOCIATIONS

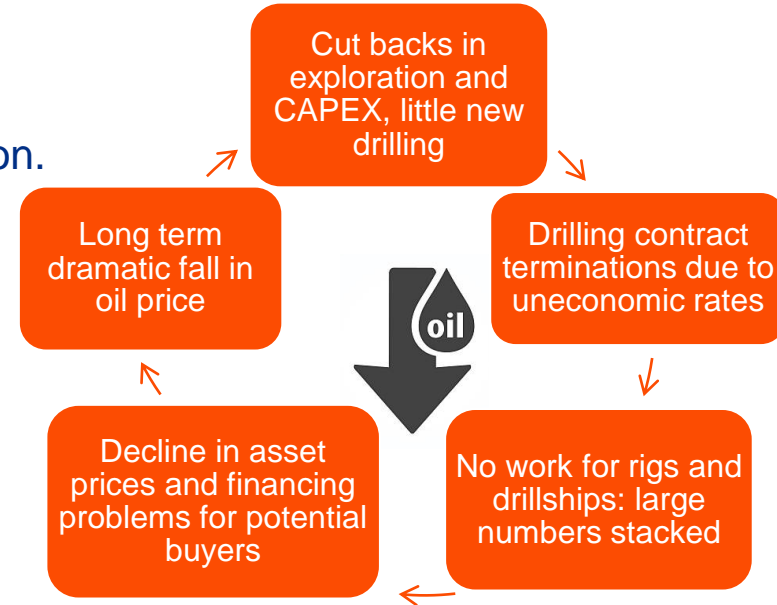


## WHAT WE WILL COVER TODAY

- **2018 STATUS OF OFFSHORE RIG/MODU FLEET**
- **CURRENT EXPOSURES FOR REACTIVATED RIGS**
- **INSURANCE REQUIREMENTS**
- **DRILLING CONTRACT STRUCTURE / CONTRACTUAL HURDLES**

**POST 2014 – DRAMATIC CHANGES IN OIL AND GAS SECTOR – PARTICULARLY UPSTREAM**

- Commodity prices impacting offshore E&P.
- Offshore E&P activity tempered by onshore production.
- Operators and contractors significantly reduced OpEx and supply chain costs.
- Expectations of operators have changed regarding technology and costs.



### A familiar tale from recent past ...

- The dramatic and persistent decline in the market
- The Operator reluctant to carry on producing due to low oil prices
- The Contractor facing real cash flow issues
- Either disputes:
  - between Operator and Contractor
  - **And/or** between Contractor and a Shipyard in Asia with an almost complete drilling rig.

- Some units emerge from stack organized, paid for, monitored and carried out by the rig owner.
- Other rigs emerge from a shipyard stack which can sometimes be on the back of an acrimonious termination.
- Our experience with handling disputed terminations and hastily arranged stacks reveal real legacy problems.
- Understanding the background to this is critical to the negotiation of the onward contracts.

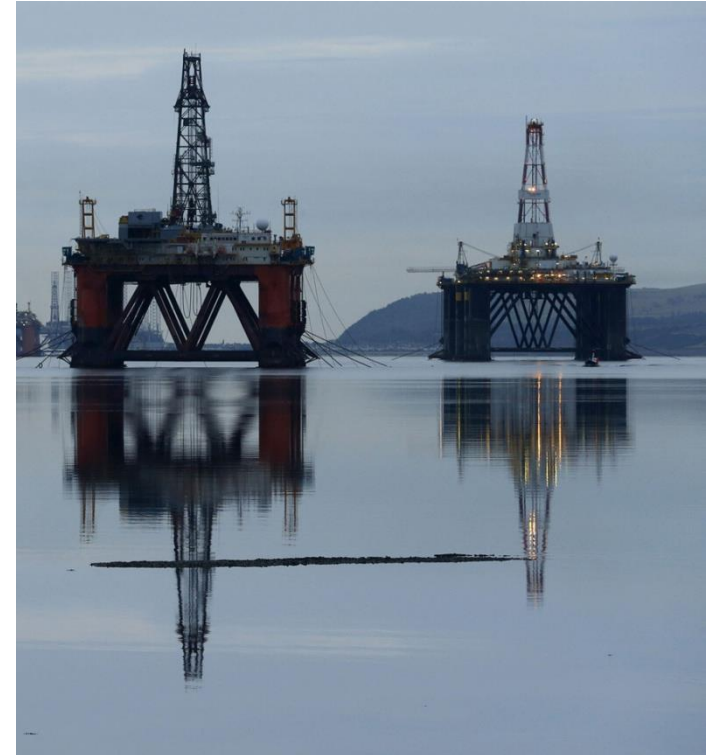


### COLD HARD FACTS

- Jeremy Thigpen (Transocean CEO) said many rigs that are currently cold-stacked will “*simply not come back to the market*”, even though a formal scrapping decision may not have been taken, due to prohibitively high reactivation costs and the fact older rigs will be displaced by modern units.

### BORR DRILLING

- Fleet of high-specification, modern jack-ups, including newbuilds yet to be delivered.



### **9 MAY 2018: NORTHERN DRILLING BUYS DRILLSHIP PAIR**

- The Oslo-listed rig newcomer, backed by billionaire investor John Fredriksen, is picking up the seventh-generation units West Aquila and West Libra for a price of only \$296 million - around half the cost under the original newbuild contracts with Seadrill.

### **9 MAY 2018: Transocean makes move on new semisub rig**

- Chief executive Jeremy Thigpen said: "*Our interest in the Transocean Norge, along with the recent acquisition of Songa Offshore, underscores our commitment to high-grading our fleet in a financially prudent manner to provide our customers with the drilling assets and expertise they seek for projects in harsh-environment and ultra-deepwater environments*".



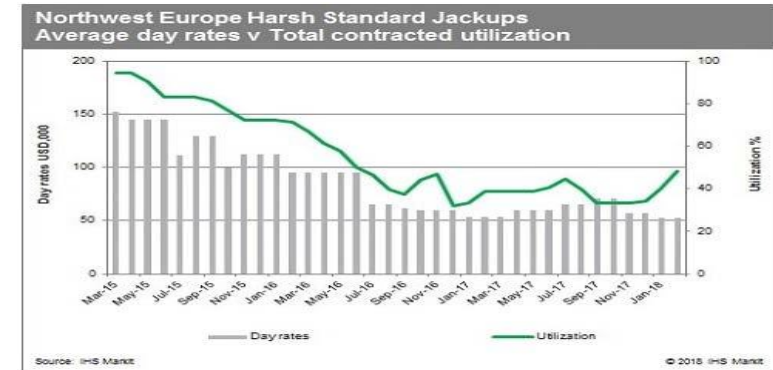
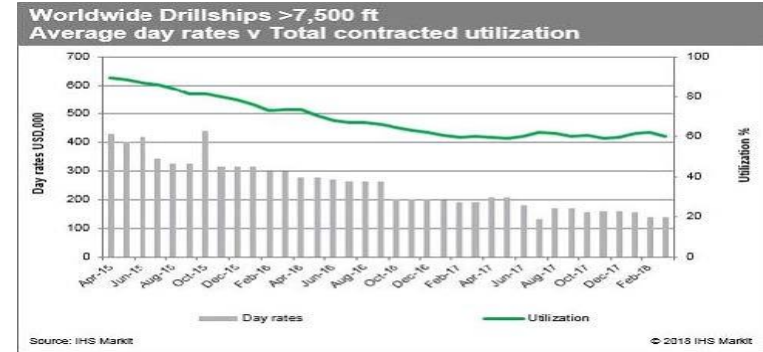


## UTILIZATION OF DEEPWATER DRILLSHIPS

- Excess of deepwater drillships maintaining a higher utilization rate than semisubmersibles
- Operators prefer to use new drillships/MODUS over older vessels
- Rates are unlikely to increase until utilization increases

## UTILIZATION OF HARSH ENVIRONMENT JACK –UPS

- North Sea and Norwegian Continental Shelf
- Increased utilization after December 2017
- More than 50% of harsh environment jack-ups remain idle





## EXPOSURES FOR REACTIVATED RIGS

### REACTIVATION EXPOSURE SCENARIO

- New gen drillship is reactivated from cold stack and DPS/digitized critical control systems are rebooted.
- Class and insurance surveys are completed - no Reactivation Warranty issued/test functioning of critical control equipment not completed and/or insufficient.
- Drillship is contracted for deepwater operations in US GOM.
- Operations are repeatedly shut down/delayed due to problems with digitized control systems.
- OEM provide remedial services but maintain that warranties were breached/compromised during cold stack.
- Damage to downhole equipment/delays occurs - Operator alleges material breach of contract due to failure to comply all applicable law and accepted offshore oil industry standards and practice.
- Operator alleges cost of replacement rig is not a waived consequential damage because Contractor could not complete obligations under drilling contract.



### REACTIVATION COSTS AND EXPOSURES INCLUDE:

- Surveys by classification societies and verification organizations – ABS 1 June 2017 Reactivation Survey format.
- Contractual obligations with service companies and OEMs:
  - Reactivating or extending OEM warranties.
  - Reinstating service intervals.
- New and innovative service contracts for offshore rigs:
  - GE/Noble Globetrotter Digital Rig
  - GE Oil & Gas/Pressure by the Hour/engageDrilling™
  - Digital asset life cycle management
- Allocating contractual risks for services vital to reactivation and maintenance.
- Insurance for reactivated rigs.



## REACTIVATION CHECK LIST INSURANCE REQUIREMENTS

THE **REACTIVATION WARRANTY** AS PER JH2009/002 (22ND MAY, 2009) IS AS FOLLOWS:

### REACTIVATION WARRANTY

*AS A CONDITION PRECEDENT TO THE LIABILITY OF THE UNDERWRITERS, THE VESSEL SHALL NOT LEAVE HER LAY-UP BERTH UNDER HER OWN POWER OR UNDER TOW FOLLOWING A LAY-UP PERIOD OF MORE THAN 180 CONSECUTIVE DAYS OR ANY PERIOD IN COLD LAY-UP, UNLESS BOTH THE VESSEL'S CLASSIFICATION SOCIETY AND A SURVEYOR APPROVED BY UNDERWRITERS HAVE EXAMINED THE VESSEL AND ALL REPAIRS AND OTHER WORKS REQUIRED BY THE CLASSIFICATION SOCIETY AND SUCH SURVEYOR HAVE BEEN CARRIED OUT PRIOR TO THE VESSEL LEAVING HER LAY-UP BERTH.*

*THE FOLLOWING REQUIREMENTS ARE, THEREFORE:*

- optional up to 180 consecutive days of lay-up unless in cold lay-up in which case they are compulsory after any period*
- compulsory after 180 consecutive days of lay-up for all vessels*

**JOINT RIG COMMITTEE LAY-UP, REACTIVATION AND MOORINGS  
CODE OF PRACTICE (COP) AND SCOPE OF WORK (SOW) 10 APRIL 2018**



## REACTIVATION CHECK LIST INSURANCE REQUIREMENTS

JOINT RIG COMMITTEE LAY-UP, REACTIVATION AND MOORINGS  
CODE OF PRACTICE (COP) AND SCOPE OF WORK (SOW) **10 APRIL 2018**

- Test functioning of equipment including:
  - Check that all control systems and equipment reliant upon software is using the latest software updates and there is an adequate firewall and computer security system installed.



### TYPICAL PROVISIONS FOR DRILLING CONTRACTS – ENGLISH LAW

- The negotiation of a drilling contract, irrespective of the state of the market, is a competitive process. A detailed specification/scope of work forms part of a tender package. Typical contracts terms are comprehensive and corporatized – not always good for the Contractor.
- Interpretations and defenses at law which might have otherwise benefited a contractor (English law principles of waiver, prevention principle and estoppel) and the ability to identify new work outside the contractual and price for it are more or less gone.
- It is not easy to imply good faith into English law contracts.
- It is in this contracting culture that units are emerging from stack.

## Drilling Contract Terms for Mobilizing Reactivated Rigs – English Law

**What does this mean for a unit coming out of stack?**

*“tests to run the drilling unit to be as close to operational conditions as possible”*, the scope of the acceptance tests may not be set out in full detail.

**Agreement to Agree?**

*"if a rig is coming out of stacked status, then further acceptance test may be performed and to be agreed between the COMPANY and CONTRACTOR"*

**Termination for Convenience**

A new structure be negotiated for units coming out of stacking?

**Coupled with this possible upgrade**

Does the procedure for this have to be reassessed?



### DRILLING CONTRACT TERMS FOR REACTIVATED RIGS

- **Rig Acceptance Criteria**
  - Based upon time period rig has been stacked.
  - Involves endurance and performance testing:
    - Electrical systems, variable frequency drives, electrical network stability
    - Generators
    - BOP stack and well control systems
    - DPS and station keeping
  - Real time monitoring capability.
  - Digitized operations and critical control systems.
- Impact on OEM warranties/maintenance contracts – have they been compromised or extended?





# CONTRACTUAL HURDLES FOR REACTIVATED RIGS

## DRILLING CONTRACT TERMS FOR REACTIVATED RIGS

### • CONTRACTOR'S REPRESENTATIONS/WARRANTIES

- Contractor shall perform the work
  - In a diligent, skillful, competent and workmanlike manner,
  - Applying engineering principles/good oilfield practices,
  - Per contract specifications,
  - In compliance with all applicable law,
  - In accordance with accepted offshore oil industry standards and practice.
  
- HSE and operational obligations in bridging documents:
  - Often incorporate industry standards and regulatory obligations.
  - Used as **overriding or controlling agreement** to ensure that Contactor's HSE program conforms with Operator's requirements.
  
- **Contractor's standard of care under these agreements ≠ reasonable care under the circumstances.**



## CONTRACTUAL HURDLES FOR REACTIVATED RIGS

### DRILLING CONTRACT TERMS FOR REACTIVATED RIG

- **Incorporated industry standards:**
  - API RP 75 – Process/mechanical design
  - API RP 16 - Marine drilling risers
  - API RP 59 – Well control operations
  - API RP 92 – Managed pressure and underbalanced drilling
  - **IADC Guidelines for Baseline Cybersecurity for Drilling Assets.**
- **Incorporated and/or applicable regulatory standards (US):**
  - BSEE
    - “New” Well Control Rule – 2018 revisions?
    - RTM Requirements
  - USCG
    - 46 CFR 109
    - Incorporating IMO MODU Code
  - **USCG NVIC 05-17 Guidelines for Addressing Cyber Risks at MTSA Regulated Facilities.**
- **Change in Law clause** – requires parties to review change in law/regulations that increase burden on contractor.



## CONTRACTUAL HURDLES FOR REACTIVATED RIGS

### INSURANCE FOR REACTIVATED RIGS

- **Insurers' reactivation warranty – test functioning of critical control systems/software/firewalls.**
- **Insurance**
  - Contractor obligated to provide insurance for minimum limits
    - CGL – including sudden/accidental pollution
    - Contingent COW
    - H&M/P&I
    - Umbrella
    - Subcontractor insurance as appropriate to services/work
  - Coverage for Company as AI

### INSURANCE MARKET

- Offshore energy premiums have decreased more than 25% since 2015 (IUMI)
- Insurers face less claim volume due to decreased activity but offshore drilling risks/exposures remain complex with high values



## CONTRACTUAL HURDLES FOR REACTIVATED RIGS

### DRILLING CONTRACT FOR REACTIVATED RIG

- **INDEMNITY/DEFENSE OBLIGATIONS**

- Catastrophic damages - Regardless of fault exceptions for gross negligence of contractor's personnel (supervisory or senior) with capped limits.
- Downhole equipment – Company capped liability if not recoverable from contractor's insurance
- Loss or damage to the hole – Contractor redrill obligation at redrill rate
- Company's obligation to indemnify Contractor's subs restricted to Contractor Group definition

- **CONSEQUENTIAL DAMAGES WAIVER –**

- Special, indirect or consequential damages
- Includes lost profits, lost/delayed production, loss of use of property, equipment, services, exemplary or punitive damages
- Waiver of consequential damages not include cost of replacement rig if Contractor does not complete contract obligations



## THE PROBLEM WITH WARRANTIES

- Warranties in contracts for the provision of drilling units are general in nature.
  - *“Company shall use the drilling unit up to the maximum stated capacity.”*
  - *“First class condition and state of repair and will fully meet the capacities, specifications, classifications, and other characterisations as detailed in the CONTRACT”.*
- Contracts can provide some do provide Company to object if Contractor "fails" to perform (as opposed to a 'breach') with the option to either suspend the work or continue at reduced daily operating rate to reflect the deficiency during the remedial period.
- The typical exclusions are LDs, agreed termination fees and agreed reductions in the day rates.

### Bringing in yesterday's experience into today



How should the rig  
be stacked?



Re-activation requirements  
and costs?



Agreements with shipyards  
and/or OEMs.



Drilling contract terms and  
warranties.



Insurance requirements.



Choice of law.



## OUR OFFSHORE OIL & GAS TEAM

- **Offshore lost production/delayed production** – representing vessel owners and operators in litigation and arbitrations in U.S. and U.K.
- **Oil & Gas E&P** –representing major oil and gas operators and contractors in offshore E&P/developments in W. Africa, GOM, Mexico and Guyana.
- **Offshore casualty, pollution and regulatory matters** – represented contractors, service companies and operators in offshore pollution and regulatory matters, in U.K. and U.S., including DWH.
- **Various offshore contractors** - multiple termination disputes arising from the current market conditions.
- **Multi contract dispute, five arbitrations** - advised on and organised a formal mediation in Dubai, where all disputes were settled.
- **Charter disputes and collisions** – involving drilling contractors and offshore service vessels.
- **Enforcement of arbitration awards** - in various countries, including in U.S., Singapore, Thailand, PRC, Dubai and Qatar.
- **Vessel Construction** – transactions and arbitrations on behalf of vessel owners and construction yards related to design, project supervision and EPC and EPCIC contracts.
- **Disputes under project and logistics contracts** - for offshore / onshore projects (including a FPSO project).



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# THANK YOU

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It should not be considered as legal advice.

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