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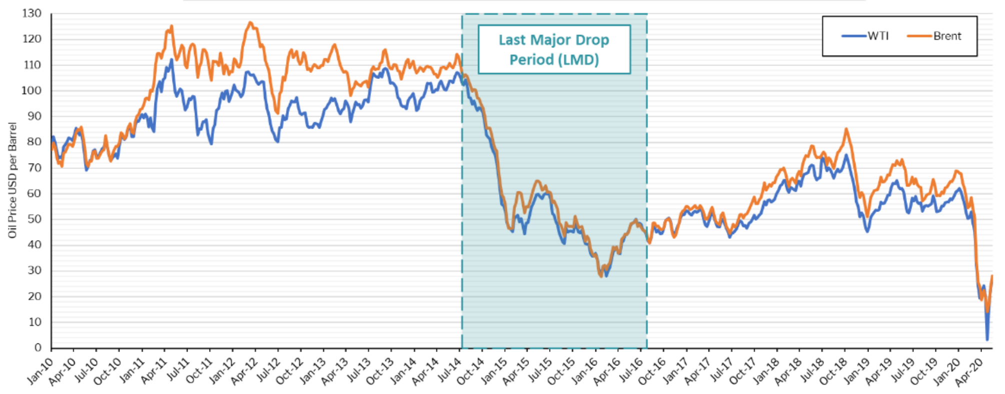
What can we Learn from the Last Oil Crash in the Current Crises?

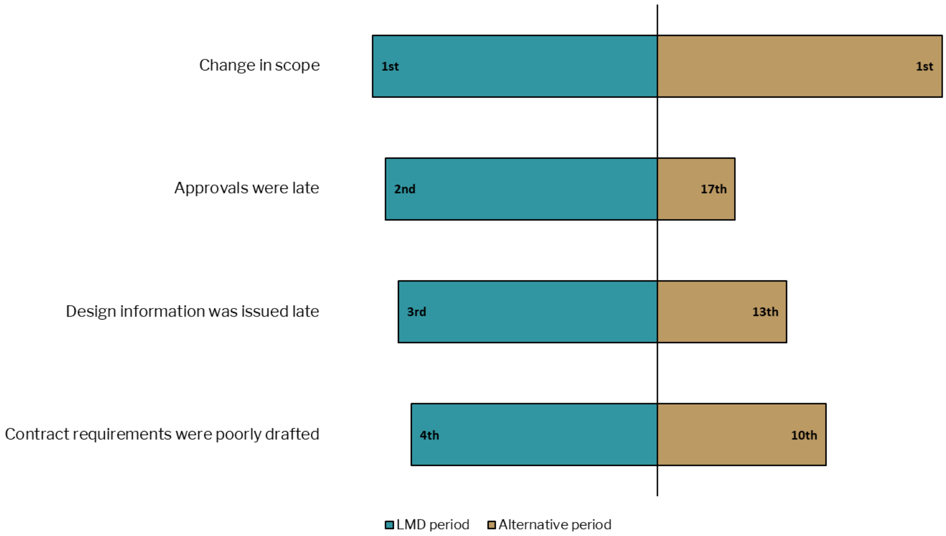
It is no secret that current and future oil and gas projects face challenging and uncertain times, due not least to the plummeting oil price swiftly, followed by the ongoing effects of the COVID-19 pandemic. The drop in oil price led to a number of project terminations, development re-appraisals and delayed start-ups while the following pandemic has had the effect of causing delays and disruption to live projects and the delayed start to others.

Operators and contractors alike are having to manage these challenging issues, and more, in the current landscape which is resulting in a marked rise in contractual claims and disputes with parties looking to protect their commercial positions.

As part of its CRUX causation programme, which collects causation and dispute data globally, HKA carried out an analysis of the effect of the last major oil price drop in 2014 (referred to in the analysis as the "Last Major Drop" (LMD) period from July 2014 to July 2016) on oil and gas projects



As an example, HKA provides analysis of the Middle East below. The CRUX analysis identified that certain causations increased significantly in the LMD period, most notably while "Change in scope" retained the "top spot" for proportion of causations, "Approvals were late" rose from 17th place to 2nd most frequent causation, "Design information was issued late" rose from 13th to 3rd and "Contract requirements were poorly drafted" rose from 10th to 4th.



Notably the two new highest causations relate to timing. These increases seen would be expected in periods of low oil price and reflect the reality of how the sector manages such instances. During periods of low oil price, operators traditionally re-appraise their operational strategies and delay project execution with the aim of limiting commercial exposure. This can, and evidently does, manifest in delay on the design and approvals process, which can sometimes be due to either re-designs or holds on stage gateway achievement markers, and subsequent delays in making sites available.

As might be expected, the prevalence of formal disputes including an element of delay rose dramatically for those projects executed within the last major drop period, from 29% to 50%. This demonstrates that, during periods of significantly low oil price, the issue of delay and time for completion comes to the fore, directly impacted by the expected, and in CRUX evidenced, delays in the release of design and approvals to enable projects to continue as originally planned.

This analysis identified, amongst other points, that the disputes that were settled rose from 14% in the non-low oil price period to 24% in the last major drop period. This reflects the commercial reality of such instances whereby, faced with tightening commercial flexibility constraints and liquidity issues, contractors generally lean more towards settling matters outside the confines of what are often expensive formal dispute resolution procedures. This could also have been driven by a change in stance from the preceding financial crisis of 2007-08 where contractors often took a more aggressive approach which, in the eyes of many, damaged relationships in the sector. Operators and contractors usually have a good grasp of where contractual entitlement lays and, in instances whereby delay has been caused due to the operators slowing down then the reality of this is generally understood and recognised by the operators as being their responsibility.

This pragmatic approach, whereby there are a greater number of settlements in low oil price periods is to be expected, and aligns with the CRUX findings of both an increase in prevalence of time-based causations (e.g. approvals are late) and the increase in the number of delay related claims.

Lessons from past low oil price periods can be utilised in understanding and forecasting what will occur in the current and future oil price drop periods. The reader should be aware, however, of the “double impact” on the oil and gas sector being the COVID-19 pandemic and the effects it is having on all sectors of business globally.

Combined with the oil price drop, demand for oil-based products has dropped further as a result of the pandemic. Significantly reduced travel and shipping has further sharpened oil producer’s development reviews which has resulted in projects being delayed, mothballed or completely abandoned. An increase in project terminations and a rise in the number of related claims from contractors regarding such matters is prevalent.

In the early period of the pandemic, the contracting landscape was taken up largely with questions about entitlement with regards to the changing issues. Was their contractual entitlement under the force majeure provisions? Perhaps a change in law, or failure to provide access to the site. This period saw a wave of notices of claim events being sent up the contracting supply chain. In some case, operators took the proactive approach and revisited the contract terms with the contractor to find a commercial solution which assisted both parties and protected the completion of the project. In other instances, such notices were met by rejection, often met with silence and occasionally replied to with notices of default down the supply chain for failure to continue working or informing contractors of their duty to manage the risk and to implement appropriate measures to mitigate and/or address the effects of the pandemic. Many notices were also rejected, as there was uncertainty that COVID-19 was the actual cause of the alleged project impacts.

This period has largely passed, albeit many effects and impacts of the pandemic are long lasting and will have continuing or unknown repercussions far into the future, and contracting parties to those oil and gas projects which have continued (i.e. not been terminated or mothballed) have submitted and continue to submit, interim claims in respect of time and cost due to the continuing effect of COVID-19.

Contractors on live oil and gas projects have experienced a range of different impacts on their work due to the pandemic. During the initial period, contractors were affected by having sites closed down, either by mandate of their client or of the relevant local authority. In some instances, sites were closed by the contractors themselves, albeit these are the minority and generally such "self-imposed" shutdowns did not last for extended durations.

In addition, contractors were impacted by external factors such as the reduction or complete stoppage of the movement of labour across international borders and labour camps, often off-site, being closed down or having restricted movement due to governmental rules or requirements. The effects of such shut-downs and restrictions can now be assessed. What creates a larger problem regarding the assessment of impact is the ongoing disrupting effect and state of uncertainty linked, in one way or another, to the pandemic.

This difficulty can be compounded by the transition from one contractual causation into another, for example where a government imposes restrictions and then, on release of those constrictions, similar issues continue. This example was seen in Singapore, where the government imposed national constraints on construction sites working. The constraints were lifted on 1 June 2020 and thus, at that point, it could be argued that an entitlement related to such government restrictions ceases. However, contractors in the region were then affected by re-mobilisation periods, restrictions on labour travel from different countries, which is a significant factor for nations such as Singapore, and 14-day quarantine periods upon arrival for all international visitors.

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Deliveries of materials and, especially, fabricated components from other countries particularly hit by the pandemic created breaks in when and how programmes of work could be delivered. In some cases, the delivery programmes could be re-scheduled to mitigate the effects of such but frequently these component parts to a project were unavoidable critical to progress.

There is a large number of varying disruptive and state of uncertainty effects re-started or continued projects are experiencing, and indeed those which have not yet commenced, will no doubt encounter. The effect of extensive home working on large, complex projects is not yet known. While the industry continues to see great advancements in using shared 4D models, such as coordinated design packages and other routes, to create seamless project controls, the impact of the pandemic will be, in part, to accelerate the need to place greater reliance on such systems. Whether the parties using these processes are able to implement and increase their use with sufficient capacity to manage these complex projects on a more remote, singular working basis is yet to be seen.

Contractors will also continue to experience issues with productivity on site. For example, a government may have imposed a temporary restriction on working hours during the height of the pandemic which resulted in a loss of 40% of the available working hours per week. Following the government's release of the restriction the national oil company continued to impose those restricted working hours, thereby continuing to severely impact the progress of works and the cost to the contractor.

It is also the case that parties to oil and gas projects need to sufficiently prepare for the risk of the second wave of the pandemic. At the time of writing, most countries around the globe are seeing an uptake in cases throughout their general populations. This may result in further restrictions put in place by relevant authorities and tighter constraints on travel and the transfer of goods and fabricated items.

The effects of disruption are notoriously difficult to ascertain and require good quality, accurate records in order to substantiate them. In addition, the more time that passes after the immediate and obvious effects of the pandemic, the harder it will be for contractors to link the root causation with the disrupting effects. Therefore, contractors must ensure that sufficient controls are implemented to accurately record the continuing disruptive effects of the current pandemic if they want to secure entitlement.

Contracting entities in the oil and gas sector are looking towards a challenging future which, in part, sees the recurrence of a COVID-19 type issue. This will inevitably lead to amended wording of force majeure and other clauses, possibly with specifically drafted pandemic clauses. The wider construction sector is still wrestling with how to fairly deal with the current situation, and no doubt will continue to do so for some time. The understanding of commercial risk for such events has changed and contracting and procurement methods related thereto will need to be reviewed and reasonably appraised, placing the risk with the party best placed to manage that risk to ensure that the recovery of the oil and gas sector can be sustainably maintained.

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