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MAKING THE MOST OF LEANER TIMES

A Contractor's guide to common English law issues

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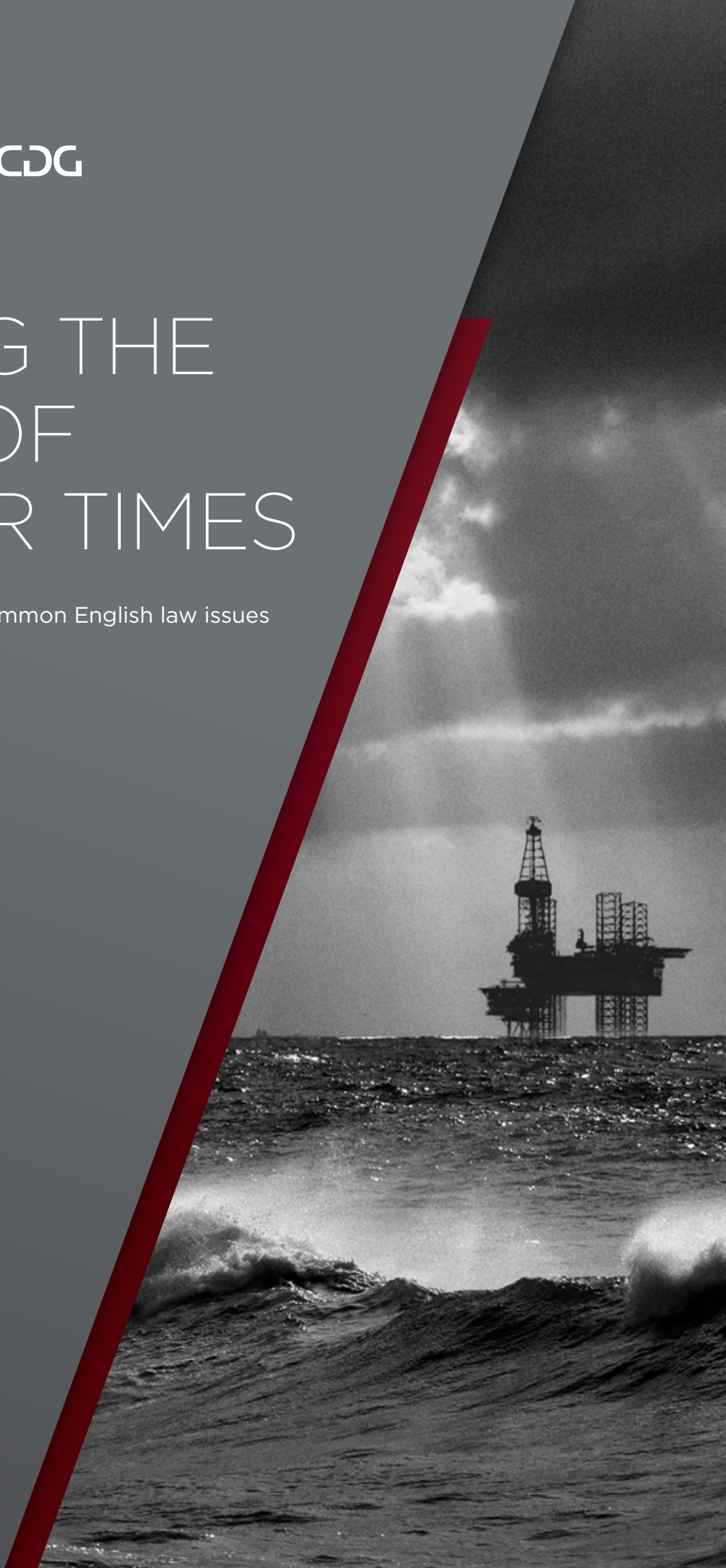

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A. INTRODUCTION

1. The new environment

From a high of around US$115 a barrel in June 2014, to a low of around US$35 in January 2016, the sudden and sustained crash in the oil market, despite recent increases, continues to cause pain for those operating in the offshore sector. For many participants in the market, survival remains the name of the game.

Whilst contractors who are managing to continue to operate in the offshore sector have had some time to adjust their business models and modes of operation to the new commercial realities, the radically different economic circumstances of recent years continue to manifest themselves in commercial scenarios quite unlike those experienced in the better times when the oil price was significantly higher. In those benign conditions, contractors had the upper hand on pricing and could be relatively assured that their contractual counterparts would adhere to their commercial bargains. The concern rather was to avoid committing for too long, or on such terms as did not allow a contractor to benefit from further upward movements in the market.

In this new era, however, contractors will commonly face quite different challenges. These can range from clients and other commercial counterparties[1] facing financial difficulties which impact on their ability to meet their contractual obligations owed to contractors, to contractors' own internal issues which are also the result (albeit indirectly) of the economic difficulties of their clients.

1 Throughout this guide, terms such as "client" *or* "counterparty" *or* "contractual counterparty" *are employed interchangeably to refer to those persons with whom a contractor has entered a contract or is considering whether to contract.*

2. The classification of today's common scenarios

(a) Client Scenarios

The continuation of the lower oil price environment is *directly* giving rise to the following client scenarios ("***Client Scenarios***") as clients, on account of resulting financial difficulties, continue to seek to reduce expenditures and improve efficiencies or, where this is not possible, fail to meet their contractual obligations:

i. clients looking to exit negotiations for *prospective* contracts;

ii. clients looking to terminate *existing* contracts; and

iii. clients defaulting under *existing* contracts.

(b) Contractor Scenarios

On the other hand, the following scenarios, whilst also the result of clients continuing to be exposed to financial difficulties on account of the significant decline in the price of oil, may rather be seen as contractor scenarios resulting *indirectly* from the lower oil price ("***Contractor Scenarios***"):

i. contractors, faced with a downturn in demand for the employment of their assets, looking to *dispose* of existing assets; and

ii. contractors, with changed views of the expected profitability of future assets, looking to *exit* contracts for the acquisition of those future assets (e.g. rig construction contracts).

It is the purpose of this guide to consider a number of the typical Client Scenarios that we commonly see arising in the present market, and to provide an overview of the relevant English law issues to which these give rise for contractors.

In due course, we intend to explore in a further guide the Contractor Scenarios that arise in the new lower oil price environment.

B. CLIENT SCENARIOS

1. Issues arising in the negotiation of *prospective* contracts

The sudden and dramatic fall in the price of oil and its consequent impact upon the willingness of parties to commit to new contractual arrangements continues to give rise to problems for contractors operating in the sector. Contractors may find themselves in long running commercial discussions with a commercial counterparty which, due to the long term impact of reduced revenues and lower operating budgets, no longer wishes to commit investment to the project under discussion and instead walks away from the discussions. With projects being as substantial as they are in the industry, contractors will often have spent a great deal of time and money in connection with such negotiations in the expectation of a lucrative deal being concluded. Situations such as this, particularly in the current market where alternative deals may not be readily available, can therefore leave a contractor who has invested heavily in such a prospective deal deeply aggrieved.

Questions that arise can include:

i. whether the other party is legally entitled to walk away; and

ii. whether the money invested in the commercial negotiations is recoverable by the contractor from the party walking away.

The answers to such questions will depend heavily upon the precise factual circumstances. There will always have to be a careful examination of the communications that have been exchanged between the parties during the commercial process, including any "electronic communications" (including emails and other forms of messaging including any text (SMS) and/or "instant" messages such as those through Skype™ or Jabber®), other correspondence, drafts of agreements, as well as an examination of what was said during meetings.

However, the following broad statements as to the approach taken under English law may go some way to assist in an assessment of a party's rights.

(a) Can a potential client or other commercial party simply walk away without consequence from the negotiations for a new contract?

Generally speaking, unless a contract has already been concluded, English law will consider a commercial party to be entitled simply to walk away from commercial negotiations with a contractor without consequence. The reason is because English law does not typically regard a party to commercial discussions to be legally *obliged* to continue discussions relating to a deal it no longer wishes to pursue.

Often, however, parties to commercial discussions will have sought to impose an "obligation" to *negotiate* or to *endeavour to reach agreement*, or similar, in a preliminary document, – for example in a "letter of intent", "heads of agreement" or similar document.

Parties are often surprised to find out that, as a matter of English law, any such attempt to seek to impose an obligation to continue to negotiate or to reach an agreement will likely not be recognised as having any binding legal effect. If so, a party will be able to walk away from the discussions for any reason and without legal consequence.

In numerous cases, the English courts have held that an express agreement merely to negotiate is not a contract because it is too uncertain to have any binding force. An attempt to provide for an obligation which is in the nature of one "to agree" certain matters will not therefore, as a matter of English law, impose any legal obligation to do so, or to negotiate or to use best endeavours to reach agreement or to accept proposals that with hindsight might appear to be reasonable.

If an agreement to negotiate is so uncertain as to not be binding, the English courts will not cure this by implying a term to the effect that they must continue to negotiate in good faith.

The English courts have determined that even an agreement to *lock-out* other parties from a commercial negotiation – *i.e.* to negotiate on an exclusive basis – may be insufficiently certain to give rise to a binding obligation. In one of the leading cases - *Walford v. Miles*[2] - the House of Lords (as the highest court in England and Wales was then titled) held that such a "lock-out" agreement will not be enforceable in law if it does not provide for a fixed period of time during which third parties are to be locked out from the negotiations. Further, the Court unanimously rejected the argument that a term should be implied requiring the vendors to continue to negotiate in good faith with the purchaser for so long as the vendors continued to desire to sell, since such a term was itself too uncertain to be enforced. The problem, the House of Lords said, was that it would be inherently inconsistent with the usual position of a negotiating party, who is in the ordinary case free to advance his own interests during the negotiations.

Therefore, it is likely that your counterparty is entitled simply to walk away from negotiations with you. Unless you have agreed a sufficiently clear and certain obligation to be enforceable, this is likely to be the case even when you have expressly sought to commit your counterparty to having to negotiate with you by means of a letter of intent or heads of agreement or similar.

As is always the case, however, the analysis will depend on the precise circumstances and so legal advice should be sought.

(b) Can a contractor recover its wasted costs when the other party walks away from commercial negotiations?

In such a case, a question we are commonly asked is whether a party is able to recover from the party who has walked away those costs which it has spent on the commercial negotiations. Typically, with high value offshore contracts, significant sums will have been spent during the commercial negotiations and a party will wish to seek reimbursement of those costs if it can.

Again, every case will turn on its facts, but an English court will generally be very unlikely to allow for the recovery of such wasted costs from the party walking away from a negotiation in the absence of an express contractual provision requiring that party to pay them.

In cases in which there is an enforceable obligation to negotiate and a party is in breach by walking away, difficult questions may arise as to whether the innocent party can recover compensation in respect of the profits – or in some part of the profits – it expected to make on the anticipated transaction. It does not necessarily follow that the other can recover substantial damages. Much will depend on the terms of the obligation and the nature of the losses. Further there may need to be a complex

analysis as to what the prospects were of a deal actually being concluded had the other party not walked away, and the prospects of that deal, had it been concluded, resulting in profits. It may be that the innocent party's losses will be discounted in accordance with the chance that the anticipated transaction would actually have been agreed and have been profitable.

KEY POINTS

In the event of an aborted prospective deal consider:

Had the parties agreed with sufficient certainty terms governing the basis on which the commercial negotiations were to take place?

If no: either party can walk away.

If yes: to walk away *may* be a breach of that agreement. In that case, a claim for damages may be open to a contractor, but only if the breach resulted in recoverable loss.

In the lower oil price environment, where the commercial pressures are continuing to result in prospective deals being aborted before a contract is concluded, contractors would be well advised to secure prior agreement from the other party to contribute towards the costs that will be wasted if that party walks away from the negotiations.

> In numerous cases, the English courts have held that an express agreement merely to negotiate is not a contract because it is too uncertain to have any binding force.

(c) Has a binding contract already been agreed?

In any instance in which a counterparty has walked away from an advanced commercial negotiation with a contractor for which we are acting, we would always wish to consider whether a contract has *already* actually been concluded upon which the contractor may advance a claim.

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[1992] 2 A.C. 128

The reason we would undertake such an analysis, even in the absence of a signed written contract, is that the English law requirements for the creation of a contract may well often be less than commercial parties may assume to be the case. If a contract has already been concluded on favourable terms, a commercial party will want to enforce that contract (whether by recovering damages for loss suffered if the other party cannot or will not perform, or by compelling the other party to perform as promised). As such, there is significant value in undertaking such an analysis.

Whilst this guide is certainly not an appropriate place for a full examination of the principles of English law which are relevant to the question of whether a binding agreement has been reached, a very basic overview may be useful.

In short, under English law, a contract will be made when the following elements are present:

i. two or more parties;

ii. who intend to enter into legal relations;

iii. have reached an agreement, by which is meant the acceptance of terms offered by one or more to the other(s);

iv. there is sufficient certainty as to those terms; and

v. "*consideration*" (by which English law means something of value "moving to" the promisor or a detriment assumed by the promisee) is provided.

Crucially, whether a contract has been formed will be determined by any court or arbitral tribunal applying English law from an *objective* perspective. This means (perhaps surprisingly) that it does not generally matter whether the parties to the aborted negotiations themselves *thought* they had agreed or even what they *thought* the terms of their agreement might be. Potentially, therefore, a commercial party might walk away from negotiations with a contractor, believing it is entitled to do so without consequence, and yet there may in fact be a legally binding contract which can be enforced by a court or arbitral tribunal in favour of the contractor.

In working with contractor clients to determine their rights, particular aspects of the above will be of critical importance in the analysis of whether a contract has already been concluded and can be enforced.

i. Be careful with offers!

Without an offer as to terms there can be no contract.

However, parties who are currently involved in commercial negotiations and who may be assessing and considering an offer by another to enter a contract should bear in mind that an offer can be withdrawn at any time before it has been accepted by the party to whom it has been made. In the current low oil price environment, therefore, a party should not proceed on the basis that, where it has received an offer, it can take its time to decide whether the offer is attractive and one that the party would wish to accept.

What may be more surprising, however, is that the English courts have held that, even if an offer is expressed to be made as capable of being accepted for a certain specified period of time, the offeror is nevertheless perfectly entitled to change its mind and withdraw the offer before the expiry of the specified period. The reason is that in such a case the offer is entirely gratuitous. By this is meant that nothing of value will have been given by the

> Conversely, care should also be taken to ensure that offers which a party would no longer wish to be accepted are not inadvertently "left on the table," because they generally remain open for acceptance until they are revoked.

recipient of the offer and, as such, there is no *consideration* in the eyes of the English courts and so no contract to be breached upon the withdrawal of the offer.

The moral of the story is that if the offer is a good one that is commercially acceptable, then a party would be wise to act promptly to secure the relevant contract by accepting the offer. This is to avoid the case where the other party withdraws its offer and walks away from the prospective deal before a contract is concluded.

Conversely, care should also be taken to ensure that offers which a party would no longer wish to be accepted are not inadvertently *"left on the table,"* because they generally remain open for acceptance until they are revoked.

In the case of a contractor operating in the offshore sector, this issue might arise, for example, when a number of offers have been made to commercial parties in the business of providing support services to the contractor. If such an offer to contract (*e.g.*, to receive and pay for certain services or supplies) has been made by contractor and the contractor no longer wishes to secure the provision of the services/ supplies offered by the supplier, then it is essential for the contractor to ensure that his withdrawal of any offer is effectively communicated to the supplier. Otherwise, suppliers in the current market may seize upon an offer that, from a strict legal perspective remains on the table, to secure what would be a valuable contract in this difficult environment.

It should be emphasised that it is not sufficient for the contractor who wishes to withdraw an offer simply to act inconsistently with its earlier offer, for example by contracting with another supplier on more favourable terms. This would probably not be regarded as an effective withdrawal of the earlier offer. Rather, the supplier that may well be hungry for such contracts in the current environment would still be able to accept the offer so as to give rise to a contract which would bind the contractor.

In the context of a commercial organisation, this does not mean that the withdrawal has to be brought to the actual notice of the officer responsible for the matter. However, communication of the withdrawal of the offer must be made effectively to the organisation.

KEY POINTS

Do not hesitate to accept an offer of attractive commercial terms.

Do not leave offers open if you no longer wish to contract on their terms.

If withdrawing an offer, ensure that notice of the withdrawal of the offer *actually reaches* the offeree.

ii. Do agreements need to be in writing?

Another issue we are often asked to consider is whether the absence of any written record means that a contract has not been concluded.

The analysis can be complex.

In circumstances where the parties are in agreement on the key terms of the deal, and it is not apparent that a written document was intended for such a deal to be legally binding, the English courts will often find that a binding agreement has been reached despite a "formal" contract not having been recorded in writing.

Occasionally, the English courts will find that a written agreement was only to serve as evidence of an agreement that had *already* been reached by, for example, a prior exchange of written communications or, in a rare case, by oral statements made in a meeting or over the telephone. Accordingly, it will be helpful to seek legal advice to determine whether an agreement may have already been reached, despite your counterparty having purported to call off the negotiation and walk away.

KEY POINTS

If a counterparty walks away from negotiations, contending that no agreement was reached because there was nothing in writing or no signed document, this does not necessarily exclude an English court from finding that an agreement has already been reached.

2. Issues arising in respect of *existing* contracts

In respect of long-term contracts, which are common in the oil and gas industry, contractors continue to be faced with questions such as:

a. Might the changed economic circumstances of the new lower oil price era be effective to reduce a client's obligations, undertaken prior to the decrease in the price of oil, and/or to excuse failure(s) by the client to adhere to the terms of that contract?

b. How might a sympathetic contractor agree to continue its existing long-term contractual arrangements with a client, albeit on terms that are more reflective of the current changed commercial realities?

c. Faced with an unsympathetic contractor, might *the client* nevertheless be entitled unilaterally to walk away from an existing contract without sanction (i.e. without the contractor having any redress against it)?

d. What rights may arise if a client or other commercial party fails to perform its contractual obligations?

Again, although the answer to these questions will depend on the particular facts of a case, we will set out an overview of the general position under English law.

(a) Might a dramatic fall in the price of oil during the life of a long-term contractual arrangement be effective to reduce a client's obligations and/or excuse their failure(s) to adhere to the contract's terms?

As a matter of English law, the freedom of commercial parties to determine their own commercial arrangements is generally recognised without significant limit.

As such, it is possible that astute commercial parties to a long-term contract may have had the commercial foresight to make express, specific provision in their contract as to the consequences for their contractual arrangement that would follow a significant fall in the price of oil. In such a case, provided that the parties have with sufficient certainty provided for the consequences of such a fall, we would expect a court or tribunal applying English law to generally be willing to uphold the parties' agreement as to the consequences.

Far more usually, however, parties will not have expressly provided for the consequences of such a dramatic change in a fundamental aspect of the market in which they are operating. In that case, clients or other contractual counterparties may look to other provisions of the contract (addressed hereafter) to seek to alleviate some of the difficulties to which the situation has given rise.

i. The potential impact of a "force majeure" provision

It is common to include a *force majeure* clause in most long-term commercial contracts.

Broadly, such a term is typically intended to excuse one or both of the parties from such further performance of the contract as would otherwise be required of them, whether in whole or in part, or to entitle one or both of them to suspend performance under the contract, or to claim an extension of time for their performance, or indeed to cancel the contract, upon the occurrence of some specified event or events which are beyond their control.

Such clauses, however, are tightly controlled by the English courts and have led to numerous court judgments over the years.

Faced with a claim by a client or other counterparty that, for example, the change in the economic environment in the offshore oil and gas industry is an event of *force majeure* entitling the client to be excused from performance of its contractual obligations, certain key issues will tend to fall for consideration:

i. "*Force majeure*" in itself has no commonly recognised meaning under English law. A provision within a contract that excuses a party from further performance "in the event of *force majeure*" will therefore be, if not hopeless, then at least an invitation for incredibly complex and expensive legal proceedings.

ii. Rather, what is intended by a reference within an English law contract to *force majeure* will depend on the terms of the individual contract and the provision made therein by the parties.

    Accordingly, at the negotiation stage of a contract, parties should take great care to seek to define precisely those matters which they intend to constitute events of *force majeure* under the contract.

    Faced with a *force majeure* claim by a client, we would consider very carefully for a contractor whether the relevant events or occurrence relied upon properly fall within the relevant contractual provision.

iii. It will be for the party who seeks to rely on a *force majeure* event to excuse performance to prove that the facts are within the particular clause.

iv. In addition to proving that one of the relevant events of *force majeure* has occurred, it will then generally also be for the party who relies on it to establish that it has prevented, hindered or delayed his performance (depending upon the wording of the relevant provision).

If the clause requires the party to prove that he has been *"prevented"* from performing under the contract or is *"unable"* to do so, what must be shown is not merely that performance of the contract has become more difficult or unprofitable, but that its performance has become physically or legally impossible.

If, however, what is required is to show that performance has been *"hindered"*, the English courts have given that word a wider scope.

v. Further, the party seeking to claim *force majeure* will usually (again depending on the terms of the clause) be required to prove:

(a) that their non-performance was due to circumstances beyond their control; and

(b) that there were no reasonable steps that could have been taken to avoid or mitigate the event or its consequences.

Very careful consideration must be given to whether a *force majeure* event has arisen such as to excuse a party from further performance under the contract, or to permit suspension or termination.

Also, *force majeure* clauses will typically specify the procedure by which such a claim has to be invoked, and the potential may therefore exist (depending on the terms of the contract) for a claim to fail if such procedure is not adhered to.

Often, there will be a requirement to give notice of *force majeure* in writing within a particular period of time. In cases where this does not take place, complicated questions about whether the giving of proper notice is a condition precedent to bringing a claim will arise. In other words, does a failure to give proper notice *prevent* a claim being brought (*i.e.* bar it), or is it just a breach of contract giving rise to a claim for damages for loss? Any party believing that it may be entitled to invoke a *force majeure* clause must ensure that the correct steps are taken to claim the relevant benefit.

As to whether the drastic fall in the market price of oil might be found to constitute an event of *force majeure* in respect of contractual commitments undertaken prior to the fall, the position will always depend on the wording of the relevant provision. However, a number of cases following the 2008 financial crash considered whether, as a matter of English law, those events amounted to *force majeure* events, and generally speaking the courts in England were not sympathetic to such arguments.

KEY POINTS

We are not aware of the English courts having yet considered whether the oil price collapse constitutes an event of *force majeure* under any particular contract, but in the absence of very clear express words, we would not expect that commercial parties will be able to rely on this as amounting to an event of *force majeure*.

ii. The English law doctrine of frustration

The English common law[3] has long recognised a principle, which is distinct from that of *force majeure*[4], by which parties to a contract may be discharged from further performance of a contract when something takes place after the formation of the contract which either (1)

makes it physically or commercially impossible for a party to perform its obligations or (2) transforms an obligation into something radically different from that which the parties had contractually agreed. In such a case, the contract is said to be "frustrated".

In the current difficult low oil price environment, a party to a contract entered into before the fall in the price of oil may try to rely upon this doctrine to excuse itself from further performance under a contract which has become unprofitable or difficult to perform.

However, the possibility of invoking this English law doctrine to bring a contract to an end is limited these days, due to the narrow ambit given to it by the English courts. In particular, the courts are not prepared to allow parties to invoke the doctrine to escape from what has proved to be a bad commercial bargain. We are doubtful therefore that a defence based on a plea of frustration would be likely to succeed.

The English courts have been very reluctant to recognise mere inconvenience, hardship or financial loss involved in performing a contract as being sufficient to frustrate it.

KEY POINTS

As in the case of *force majeure*, whether a contract has in law been frustrated will always have to be considered in light of the particular facts and circumstances of a case.

The English courts have been very reluctant to recognise mere inconvenience, hardship or financial loss involved in performing a contract as being sufficient to frustrate it.

It is unlikely that a party will be entitled to claim that its contract has been frustrated by the recent fall in the oil price so as to excuse further performance.

(b) How might a sympathetic contractor agree to continue his existing contractual arrangements with a client on different terms?

Faced with a desire to maintain relationships for future business, anecdotal evidence suggests that some contractors in the oil and gas sector are permitting their struggling clients and other contractual counterparts to renegotiate existing long-term contractual obligations, agreed before the collapse, to account for the radically different commercial realities of today.

It may therefore be helpful to consider some of the issues which arise in this context.

i. What are "subject to contract" negotiations?

The first is to consider the employment of the words *"subject to contract"* in the course of any written or oral commercial discussions for the renegotiation of an existing contract[5].

3
The "common law" means that body of law which is made by the courts through their judgments, rather than by the legislature.

4
Force majeure *deriving rather from the parties' agreement itself.*

This phrase is often overlooked when negotiations are under way and yet it can be an extremely useful way of avoiding the risk that parties are later held by a court or tribunal to have agreed a contract (or variation to an existing contract) even though they did not intend to do so or believe that they had done so.

In short, the use of the expression *"subject to contract"* will generally be regarded by the English courts or arbitral tribunals as denoting that the parties did not intend their negotiations, whether written or oral, to be effective to bring about a variation of their agreement or indeed a new agreement until they have reduced their agreement into writing and executed that written contract, at which stage the "subject" is lifted.

Accordingly, the use of the expression will tend to be effective to protect a party from the other party to negotiations later contending that a variation or a new agreement had been reached even though the parties did not sign any written agreement.

ii. How to effect an agreement to vary existing terms

As a matter of English law, parties are free by mutual agreement to vary, modify or alter the terms of a contract.

KEY POINTS

Unintended consequences can be avoided by expressly describing as *"subject to contract"* any preliminary commercial discussions for a prospective contract or any negotiations about a potential variation to an existing contract undertaken to alleviate difficulties suffered by a party to that contract.

Unless the existing contractual terms provide otherwise, such a variation may be made orally or in writing. However, contracts will often provide for the means by which the terms of the contract may be varied. They will commonly stipulate that the variation must be effected in writing and that such variation should be signed by certain authorised persons on behalf of each party. Care should be taken to closely follow any specified procedure.

Failing to do so will not necessarily invalidate any subsequent variation, but often it will do so.

Alternatively, the parties may decide to release themselves from any further performance required under their existing contract so as to put in place instead a *new* contractual arrangement. A contractor may, for example, wish to agree to allow a client or other counterparty to make a reduced regular payment. Implementing this by means of a new contract may be considered a cleaner method of defining the parties' new contractual obligations applicable in the new environment.

In such a case, the parties will wish to carefully document the client's (and contractor's) release from those future contractual obligations which remain outstanding under the current contract. As a matter of English law, we would expect a client to require that its release by the contractor be effected by means of the parties executing a deed[6] as this dispenses with the necessity of the client proving that the client gave some consideration[7] in case there is any dispute later about the binding nature of what was agreed. The deed should be drafted to make it clear that its intent is to discharge the client (and the contractor) from further obligations under the relevant contract. No particular form of words would be required

to constitute a valid release, but care should be taken to ensure that the words are sufficient to release the relevant obligations. The release would also be drafted so as to ensure that any claims which may have arisen under the parties' agreement to date are also settled and released so as to avoid the possibility of claims being brought later. In the event, that a contractor wishes to preserve known claims that he may have against a client, the contractor will wish to "carve out" these claims from the general release and settlement.

KEY POINTS

A variation of existing terms should be clear and should follow any requirements of the contract itself.

When executing an agreement to release the parties from their outstanding obligations, remember to address potential accrued claims.

(c) Faced with an unsympathetic contractor, might the client nevertheless be entitled unilaterally to walk away from an existing contract without sanction (i.e. without the contractor having any redress)?

If the client is struggling to perform or has determined that the deal it made when prices were higher is now a bad deal for it, it will be looking for opportunities to exit its contract.

5
The use of the "subject to contract" prefix can equally be employed in the context of a negotiation for a new *contract.*

6
This is a particular type of legal agreement recognised under English law, which involves certain formalities being met if it is to be legally effective.

7
As detailed elsewhere in this guide, consideration is something of value which the courts require to be given if they are to recognise an agreement as binding under English law.

As detailed above, it is unlikely that the doctrine of frustration will allow the contractor's client an escape route from his costly contract. Unless, there is an express provision in the contract which entitles the client to walk away due to the collapse in the price of oil or to be excused from performance of its obligations, the client may instead seek to contend that the contract has been brought to an end by the *contractor's* own breach of contract.

A breach of contract by a contractor may indeed provide an invaluable "get out" for a client looking to exit a now unprofitable contract. In the current difficult financial times, we would expect ever more cash-strapped clients and other commercial parties to be actively monitoring the performance by contactors of their long-term contracts agreed prior to the oil price collapse. In particular, clients of contractors who are no longer able or willing to bear the burden of contracts entered into in better times, will be looking to identify opportunities to exit costly contracts by contending that a breach of contract by the contractor has given rise to such a right of termination and exit[8].

KEY POINTS

From the perspective of a contractor providing services to a client under a long-term contract agreed when the oil price was significantly higher, care should be exercised to ensure compliance with contractual obligations.

This will minimise the risk of a contractor "gifting" to any client a right to walk away from a long-term contract which may now be very costly for the client, but lucrative for the contractor.

From the perspective of a contractor providing services to a client under a long-term contract agreed when the oil price was significantly higher, care should be exercised to ensure compliance with contractual obligations.

(d) What rights may arise in the event that a struggling client or other commercial party fails to perform its contractual obligations?

As a general proposition, any failure by a contractor's client to perform as required by the contract will give rise to a cause of action entitling the contractor to claim damages in respect of its losses flowing from the client's breach.

In addition, a breach of contract by the client may also entitle the contractor to treat itself as discharged from its future obligations under the contract. In a case where such a right is exercised by the contractor, the contractor will also usually be entitled to bring a substantial damages claim for compensation to be paid by the client or other party in respect of the losses the contractor has suffered by the contract coming to an end.

For the reasons detailed below great care must be taken by any contractor in determining whether such a right to treat a contract as discharged has arisen.

Below follows some headline information on some very important aspects of English contract law.

i. When will a contractor be entitled to treat a contract as discharged?

There are a number of instances in which a contractor would be entitled to treat its contract with a client as discharged.

8
A client may similarly be looking to identify a means of exiting an ongoing contract with a view to renegotiating *the terms of that contract (for example, to secure a lower day rate) as the "price" for not exercising its right to terminate.*

Commonly, the right will arise when a client or other counterparty fails to perform as required under a contract and such failure involves either:

i. a breach of a term of the contract which as a matter of English law is to be regarded as a *condition* of the contract; or

ii. a breach of a term of the contract which is not regarded as a condition, but rather what in law is known as an *innominate term* and the breach is so serious as to deprive the contractor of substantially the whole benefit of the contract which it was the intention of the parties (as expressed in the contract) the contractor should obtain as consideration for performing his further undertakings under the contract.

It is beyond the scope of this guide to consider how English law goes about classifying the various terms of a contract (*i.e.*, whether a term is a condition or an innominate term[9]).

However, as indicated above, in the event of a serious breach of contract by a client or other counterparty, a contractor would be well advised to seek legal assistance in determining what consequences may arise from such a breach, particularly given the risks identified below which may arise if prompt action is not taken in respect of such a breach.

An alternative circumstance in which a contractor may become entitled to treat a contract as being discharged arises when the client or other counterparty *renounces* the contract.

A renunciation results when one party to a contract by its words or conduct evinces an intention not to perform the contract, or expressly declares that it is unable or will be unable to perform its obligations under the contract in some essential respect. It can occur before or at the time fixed for performance.

In a case where a party expresses an intention *before* the time at which it is required to perform the contract that it will break it, or act in such a way as to leave a reasonable person to conclude that it does not intend to fulfil its part of the bargain, this is said to constitute an "anticipatory breach of contract".

ii. What should a contractor do when a right to treat a contract as discharged may have arisen?

In any situation in which a contractor considers that a client may through its words or conduct have given the contractor the right to treat the contract as discharged, great care must be taken.

As a priority, the contractor should seek legal advice to determine that such a right has in law arisen.

One very serious possible outcome if care is not taken is that a right to terminate has not arisen, and yet a contractor purports to exercise a right to treat the contract as discharged. Such an act by a contractor would then itself be unlawful and would probably entitle its client to treat the contract as discharged (and to bring a significant damages claim against the contractor).

Even if the contractor has obtained a right to treat the contract as discharged, the contractor will still have to determine quickly whether it wishes to *"accept"* the discharge of the contract by the other's breach or to *"affirm"* the contract. The consequences of such a decision are significant.

On a contractor's acceptance of a repudiatory breach by its client, the contract will be treated as discharged, the parties will be excused from any further performance due under the contract and the contractor will instead be entitled to sue the client for such losses as the contractor has suffered (which might[10] include the profits that the contractor expected to make over what would have been the remainder of the life of the contract).

However, where a contract is affirmed, not only will the parties be required to continue to perform their outstanding contractual obligations, but the contractor's claim for damages in respect of the breach will be limited as compared to those available on the acceptance of the repudiatory breach. This is because, where the contract is affirmed, such damages claim will be calculated having regard to the continuance of the contract.

KEY POINTS

A contractor must be very careful to ensure that he does not, when deciding whether to affirm the contract or to treat it as discharged, inadvertently take some step, or by inaction, affirm the contract.

If a contractor affirms the contract, any subsequent attempt to treat the contract as discharged may be a repudiatory breach of contract by the contractor, thereby entitling the client to treat the contract as discharged and claim damages from the contractor.

3. Conclusion

With the sustained lower oil price, contractors continue to face operating in a radically different commercial environment with different commercial challenges. There continues to be great uncertainty and risk in the market because the effect of the sustained fall in the oil price has been to destabilise previous long standing commercial relationships. Parties' commercial motivations and behaviours are now often changed and contractors need to be aware of the risks that exist under English law as detailed in this guide, and to be ready to act appropriately to avoid or to minimise these risks. An astute contractor should, however, be able to navigate his way round the challenges and avoid the worst consequences through a proper appraisal of the legal rights and duties existing in the changed circumstances.

9
There is a third class of contractual term under English law - "warranty" - the breach of which cannot ever give rise to a right to treat the contract as discharged, but which upon a breach only sounds in damages.

10
This is subject to any applicable and effective exclusion/limitation of liability clause.

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James also assists clients to obtain orders (including freezing orders) from the English court in support of both domestic and foreign court or arbitral proceedings, and directs and manages for his clients related foreign court or arbitral proceedings. Historically, he has a broad background in litigating/arbitrating general commercial disputes, having acted for clients in sectors as diverse as telecoms, engineering/construction, banking/financial services, oil and gas, aviation, IT and retailing.

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