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Editorial Office
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862
www.lexisnexis.com

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Making the Most of Leaner Times: A Contractor's Guide to Common English Law Issues—Part I

By James Brown*

The sudden and sustained crash in the oil market between June 2014 and January 2016 continues to cause pain for those operating in the offshore sector. In this new era contractors will face many challenges. The purpose of this guide is to consider a number of the typical client scenarios arising in the present market, and to provide an overview of the relevant English law issues to which these give rise for contractors. In this first part of the guide, the author focuses on issues arising in the negotiation of prospective contracts. The second part of the article, which will appear in an upcoming issue of Pratt's Energy Law Report, *will discuss issues arising in respect of existing contracts.*

From a high of around $115 a barrel in June 2014, to a low of around $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]

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* James Brown is a partner at Haynes and Boone CDG, LLP, litigating and arbitrating complex, high-value engineering/construction disputes for international clients operating in the shipping and offshore oil and gas sectors.

[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.

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.

THE CLASSIFICATION OF TODAY'S COMMON SCENARIOS

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:

- clients looking to exit negotiations for *prospective* contracts;
- clients looking to terminate *existing* contracts; and
- clients defaulting under *existing* contracts.

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"):

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

Contractor Scenarios that arise in the new lower oil price environment are beyond the scope of this guide.

CLIENT SCENARIOS

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:

- whether the other party is legally entitled to walk away; and
- 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 statement as to the approach taken under English law may go some way to assist in an assessment of a party's rights.

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 in law *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.

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.

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[2] [1992] 2 A.C. 128.

Again, every case will turn on its facts, but an English court will generally be very unlikely indeed 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.

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.

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, consider whether a contract has *already* actually been concluded upon which the contractor may advance a claim.

The reason for 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 favorable 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:

- two or more parties;
- who intend to enter into legal relations;
- have reached an agreement, by which is meant the acceptance of terms offered by one or more to the other(s);
- there is sufficient certainty as to those terms; and
- "*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.

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 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 emphasized 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 favorable 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 organization, 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 organization.

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.

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.

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The second part of the article, which will appear in an upcoming issue of *Pratt's Energy Law Report*, will discuss issues arising in respect of existing contracts.