The impact of Covid-19 on the energy & natural resources sector

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Overview

The impact of Covid-19 on the energy & natural resources sector has been severe and unprecedented. Findings from Oil and Gas UK (OGUK) suggest that 2020 could be the first year since 2009 when the demand for oil has diminished. The oil price, which was already reeling from the Russia-Saudi Arabia price war, has plummeted, exploration and development projects have been suspended, and, as a result, it has been predicted that oil and gas investments in 2020 could be cut by USD 30 billion.

The simple continuation of current operations has proved a struggle. With statistics suggesting that anywhere from 25% to 30% of the world's population is under lockdown, borders and airports being closed to international travel, and with governments scrabbling to comply with their repatriation obligations, facilities are being manned with reduced, and in some cases skeletal, staffing levels.

Consequently, the following scenarios and problems are being grappled with across the sector:

» The suspension of exploration and development operations. Drilling commitments found in exploration licences and production sharing contracts are proving either impossible to comply with or economically unviable. Announcements have already been made about the suspension of certain projects (for instance off the coast of Gambia) for this very reason. This will have a knock-on effect on joint operation budgets and work programmes which will need to be rewritten. Furthermore, the low oil price will mean that the ability of parties involved in such joint operations to recoup their expenses as "cost oil" will be significantly curtailed.

» The prospect of the shutting-in/sealing-off of wells as a result of manning levels on drilling rigs, FPSOs and the like falling below the level required by HSE regulations and the reasonable and prudent operator standard. The initial response to Covid-19 in this respect was precautionary, with operators reducing the number of people working at their facilities as a preventative measure. However, daily reports have now begun to emerge of off-shore workers being diagnosed with Covid-19. To give one example, news broke on 27th March 2020 of a crew member working on a FPSO in the Lancaster field in the West of Shetland area being been evacuated to the mainland and subsequently testing positive for Covid-19 (and one only needs to look at the example of luxury cruise liners to see how easily the virus is capable of spreading offshore). Whilst work on rigs/FPSOs appears to be proceeding as normal for the time being, with the travel restrictions in place and the need to rotate out current personnel, that position could change rapidly.

» Shipbuilding and offshore construction projects have been or are likely to be halted, whether due to the lack of demand, the need to scale back investment, or the simple unavailability of the work force (or the inability of buyers' crews to reach newbuilds that are otherwise ready for delivery).

The foregoing will inevitably give rise to disputes. Specific issues to bear in mind include the following:

» The requirements of the "reasonable and prudent operator" standard. At what point does this standard permit, or even positively oblige, the operator of an offshore facility to cease operations? The limited judicial guidance on the meaning of this standard has suggested that it can only be relied on by a party actively seeking to perform its contractual obligations (Scottish Power UK Plc v BP Exploration Operating Co Ltd [2015] EWHC 2658 (Comm)), with no consideration having been given to the situation where a party is said to be unable to perform its contractual obligations as a result of a health and safety risk affecting the provision of the contractual services. In a similar vein, disputes are likely to arise about the "good oilfield practice" standard. The scope of these standards also feeds into the next issue under consideration, the operation of force majeure provision, as many such provisions in the offshore industry require the affected party to have acted as a reasonable and prudent operator and/or in accordance with good oilfield practice before they can take the benefit of the provision.

» The operation of force majeure/"hardship" clauses. Disputes have already started to crop up with reports indicating

that China's state-owned CNOOC has declared force majeure on LNG contracts, with some of the affected suppliers (including Shell and Total) having rejected this. Particular points over which arguments are likely to rage in the coming months are as follows:

- ***Prevention or hindering of performance***. The variety of different causation issues that could arise is staggering. The first question to be asked is what impact is the relevant force majeure event required to have under the provision in question? Many clauses in operation require performance to be prevented by the event in question. Provisions of this nature can only be satisfied where performance of a contractual obligation has been rendered legally or physically impossible (rather than more expensive). Under such provisions, the fact that local demand for oil & gas has fallen off a cliff as a result of Covid-19 may not assist the party declaring force majeure (albeit compare the position under certain commonly used hardship clauses). Even under the more generously worded force majeure provisions, which require performance of the obligation merely to be hindered, it is questionable whether the economic viability of the contract is something which brings the clause into operation. These are age-old topics which English law courts and tribunals are going to be asked to revisit in the foreseeable future. Prevention issues could also arise in respect of absentee workforces. What will the position be in respect of workers who refuse to come to work in the present environment? Such individuals may, depending on their position, be properly regarded as "essential" workers. To the extent that operations have to be ceased due to their absence, will it be argued that this does not amount to a qualifying act of force majeure in circumstances where the employer ought to have adopted a tough line and, if necessary, sourced an alternative workforce (if it could)?
- ***Notice provisions***. It suffices to say that giving notice under force majeure provisions will not be top of the list of priorities of companies struggling to keep their operations running. One argument likely to be rehearsed over the coming months will be the need to give notice of an event whose existence and impact is dominating the global news cycle.
- ***Interplay between force majeure provisions and the common law doctrine of frustration***. Reliance on the common law doctrine of frustration has waned over the last 20-30 years with the increasing proliferation of sophisticated force majeure clauses. The Covid-19 pandemic is likely to expose some of the limitations and lacunae existing in the provisions commonly in use in the market. This will give rise to the question of whether, to the extent that contracts include a force majeure provision, but that provision has not been engaged or cannot be relied on under the present circumstances, the very existence of the provision precludes reliance on the common law doctrine of frustration. The traditional answer to this question adopted by the Courts has been to ask whether the contractual clause has made "full and complete provision" for the relevant event – if so, reliance on the doctrine of frustration is not permitted.

- The operation of Material Adverse Change clauses. Provisions of this nature are usually found in acquisition, financing and other similar commercial agreements, and are likely to be invoked in the current circumstances. Any party looking to divest itself of oil and gas interests via a share purchase agreement or the like will be looking carefully at the extent to which any downturn in operations pre-completion is covered by clauses of this nature. Historically, such clauses have rarely been relied upon and there is limited judicial analysis of them. Relevant considerations are likely to include when the contract was concluded (i.e. were the parties aware of Covid-19 at the time of transacting?), whether the adverse change has a substantial effect on the parties' ability to perform the contract, whether that change (and its effect) is enduring or just transitory, and, perhaps most obviously, the precise wording of the clause in question.
- Reliance on the common law doctrine of frustration. This will be the fallback position of parties unable to rely on force majeure provisions (or for whom the protection of their force majeure provision is inadequate). Similar considerations will arise in this context as to the extent to which performance of the contract has been rendered radically different from that envisaged, or merely more expensive/less profitable. In addition, insofar as contracts concluded in the last three months are concerned, i.e. in knowledge of the coronavirus outbreak, the question will arise as to whether that knowledge prevents reliance on the doctrine of frustration.

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Chris has a broad practice encompassing all areas of commercial law, with a particular focus on dry shipping, commodities, energy, and insurance disputes. He has appeared extensively in the Commercial Court, representing clients at all stages of proceedings, from urgent pre-action interlocutory applications all the way through to trial. Chris also appears regularly in both domestic and international arbitrations, and has undertaken cases before tribunals in London, Zurich and Hong Kong.

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