Subcontracts with Asian yards: Challenges and risks from a legal perspective

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"Norwegian yards miss out on three out of four contracts"
Recent contracts awarded to Asian yards – examples

- Valemon (topside) – BNOK 2,3
  - Company: Statoil
  - Contractor: Samsung (South-Korea)

- Mariner (topside) – BNOK 11,5
  - Company: Statoil
  - Contractor: Daewoo (South-Korea)

- Dagny (topside) – BNOK 6,1
  - Company: Statoil
  - Contractor: Daewoo (South-Korea)

- Ivar Aasen (topside) – BNOK 4
  - Company: Det norske
  - Contractor: SMOE (Singapore)

- Aasta Hansteen (topside) – BNOK 10,5
  - Company: Statoil
  - Contractor: Hyundai (South-Korea)

- Martin Linge (topside) – BNOK 8,1
  - Company: Total
  - Contractor: Samsung/Technip (South-Korea)
New markets for Norwegian suppliers – examples

- Aasta Hansteen: Fire protection systems, MNOK 50 <
  - Company: Hyundai (South-Korea)
  - Contractor: Fire Protection Engineering AS

- Valemon: Various subcontracts, MNOK 760
  - Company: Samsung (South-Korea)
  - Contractor: Various Norwegian suppliers

- Goliat FPSO: Signbords
  - Company: Hyundai (South-Korea)
  - Contractor: Rumag

- Seadrill Jack-up: Freshwater systems
  - Company: Dalian (China)
  - Contractor: Norwater AS
North Sea fabrication filling order books

A high level of fabrication activity in and around the North Sea is attracting new players. Elaine Maslin reports.

Platform fabrication for new installations in North Sea will reach fever pitch this year as a historically high number of facilities are completed for load out.

Yards around Europe, including Norway, the UK, Italy, The Netherlands, Spain, and Sardinia, are all busy completing jackets and topsides for North Sea projects.

year later and Chevron's 292m-long Rosebank FPSO after that, both west of Shetland.

In addition, and in construction more locally, there is a growing amount of brownfield work, including new compression or accommodation modules or satellite platforms to extend life or increase capacity on fields.

IHS Petrodata, based in Aberdeen, says: “While the North West Europe region is undoubtedly dominated by subsea tieback projects, feeding so-called hungry hosts, the last couple the planning stage, with a status of potential projects coming to tendering come to this year and the end of the year with a that is an additional 13 platforms. In fact, in 2013 there are 13 platforms in the planning stage and a further 13 are platforms. Of course, not all projects will fall by the wayside; the most, overall, the projects looking fairly strong.”

According to engineering consultancy AMEC’s proj
Today's topic
Content

- The procurement model
- Which contract terms to choose?
- A comparison of the Norwegian Fabrication Contract 2007 and the General Terms & Conditions of Korean yards – some significant risks
- Applicable law, dispute resolution and enforcement
The procurement model
The procurement model (simplified version)
The contract
Which contract terms to choose?
The choice of contract should (as always) be decided by the nature of the supply:
- Supply of equipment (valve, instruments etc.)
- Large modules (living quarters etc.)
- Commodities (pipe, cables etc.)
- Services

How is this dealt with today?
- Norwegian suppliers are familiar with, and tend to prefer NF 07, NTK 07 – amended to fit its intended purpose
- Standard form contracts from the yards?
- Back to back?
Some cultural risks
Said in relation to the budget overruns at Goliat, Yme, Skarv and Valhall:

"Significant parts of the production units for these four projects have also been built by foreign yards. Building in compliance with Norwegian standards, the so-called Norsok standard, has proven to be a challenge."
Lack of knowledge on Norwegian standards

TU.no 6. June 2013: "Figures show that Norwegian yards are cheaper than Asian":

- Said in relation to a report prepared by Rystad Energy on average production cost and delay in delivery of topsides to the NCS from 2000 until today:

"Asian yards are extremely skilled in fast and cheap deliveries in accordance with clean cut blueprints, however any variation to the work will hamper the process. They have no culture of dealing with variations, nor any unforeseen circumstances".
Lack of knowledge on Norwegian standards continue

Standard.no 2013: "Teekay: Korean yard builds vessel using Norwegian standards":

- Said in relation to the construction of a floating production vessel at Samsung for use at the NCS:

"Asian yards in general are a bit skeptical when presented with the requirements of the Norsok standard. They are used to comply with more prescriptive regulations."

"It proved to be a big challenge to have an Asian yard understand the importance of HSE and material handling throughout the whole process, like a read line characterizing all parts of the vessel."
Said by independent industrial sources in relation to the BNOK 7,6 budget overrun and delays at the Hyundai-yard:

"It's chaotic. (...) It has been said in meetings that one must start using common sense instead of NORSOK."

Identified potential reasons:

"Limited capacity, competence, experience and general knowledge on Norwegian regulations/NORSOK with our FPSO EPC contractor"

"(...)subcontractors do not possess sufficient knowledge on Norwegian regulations and specific requirements which must be met in order to operate on the Norwegian shelf."
Different challenges in Asia

- Cultural differences
- Different legal systems
- Local differences in requirements as to the shape and content of contracts
- Differences in quality and efficiency
- Differences in risks should be reflected in the price

Offshore.no 12. February 2013:

"Frightened by the Asian wave"
Due diligence and proper preparation is essential

Power of attorney and authorization procedures

Negotiations may appear chaotic:
- Multiple people involved
- The decision-maker may be hard to identify
- Discussing topics and provisions apparently without any logic
- Fear of committing personal mistakes, thereby losing respect

Western cultures: Time is money
Asian cultures: Time is a weapon
Some legal risks
NF 07 vs. Korean yards' standard terms & conditions

- The balance between the parties
- Completeness
- Wording and interpretation
Delivery terms and deadlines

- Delivery terms should be clearly defined
- Deadlines need to be carefully examined
  - Delivery date / sail away
  - Other deadlines
Variations: General features and provisional payment

- NF 07
  - Sophisticated variation order system (Art. 12-16)
  - Provisional payment if dispute on the effects of a Variation Order (art. 15.2)
- The yard-contracts
  - The variation order system varies from contract to contract
Payment

- Payment terms must be carefully examined
- Payment terms must be clearly defined
- Entitlement to payment should be within Supplier's control
- The yard's breach of its payment obligations
Liability for defects and delay

- Defects
  - Rectification costs
  - Cap on rectification costs

- Delay
  - Liquidated damages
  - Cap on liquidated damages
  - Other remedies for delay
Warranty period

- **NF 07**
  - Two year warranty period from the time of issuance of a Delivery Protocol or when the buyer takes possession of the work

- **Yard contracts**
  - Somewhat longer warranty periods (until 4 years)
  - Duration of the warranty period is often linked to the main contract between the yard and the end buyer.
Limitation of liability

- **NF 07: Firm liability provisions**
  - *Global liability cap on 25% of the contract value*
  - *Indemnity for indirect losses*

- **Yard contracts: Few liability provisions**
  - *Either no general limitation of liability or high global cap*
  - *Liability for the yard's indirect losses not excluded, or if so only to a minor extent*
Applicable law, dispute resolution and enforcement
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- Applicable law – Local law vs. English law
- Singapore and Hong Kong founded on English law
- Courts in China – independency and competence?
- No bilateral agreement between Norway and China and Korea with regards to enforcement of Norwegian judgments.
- China and Korea has ratified the 1958-Convention on the Recognition and Enforcement of Foreign Arbitral Awards – The "New York Convention".
Example of arbitration clause

This contract is governed by the laws of England.

Any dispute arising out of or in connection with this contract, including any question regarding its existence, validity or termination, shall be referred to and finally resolved by arbitration in Singapore in accordance with the Arbitration Rules of the Singapore International Arbitration Centre ("SIAC Rules") for the time being in force, which rules are deemed to be incorporated by reference in this clause.

The Tribunal shall consist of three arbitrator(s).

The language of the arbitration shall be English.
International arbitration in Singapore

- Closing in on Hong Kong as the preferred seat of arbitration in Asia
- Political and social stability, good airline connections, hotels and courtrooms (Maxwell Chambers)
- Solid tradition on the "rule of law" supported by pragmatic and well developed court system and SIAC-Rules which is based on UNCITRAL Model Law
- While people from China prefer Hong Kong, people from India and South-Asia would prefer Singapore due to the distance and independency from China
"Historic analysis of all projects undertaken on the Norwegian Continental Shelf since 2000 show that budget overrun for topside work has been five times as high for foreign suppliers compared to Norwegian suppliers.

Similarly, the number of delays attributable to conditions under the yard's control have proven to be significantly higher for foreign yards. In average, delivery from foreign yards was 14 months delayed while the figure from Norwegian yards only show an average delay in delivery of one month."
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