

Oil price volatility - risks and opportunities in 2015

January 22, 2015 | written by Ben Knowles

Update 1 - Impacts on long term supply and service agreements



During the second half of 2014, and at the start of 2015, we have seen increasing global, and indeed market, instability across a wide range of commodities. Crude oil producers have been particularly vulnerable to 'the new instability', caught in a perfect storm of relative decreasing demand, increasing production volumes and changing geopolitical factors. In the short term at least, a straw poll of commentators doesn't identify significant upward pressure on crude oil prices, hinting that the current trend for lower crude oil prices is set to be with us for a while.

We are all wrestling with the ramifications of this new paradigm and, as lawyers, we are starting to see the early impacts of the new environment. Immediate, direct effects such as the cancellation of projects in the oil & gas sector due to economic unviability, and layoffs in areas with higher

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production costs such as the North Sea, are already starting to seep into the wider economy, and their final impact is still unknown. Questions, such as how net crude importing nations might use the additional funds now in their coffers, and how net exporters such as Venezuela, Nigeria and Russia can fill the income gap, are now at the forefront of global attention. What is certain is that there will be winners and losers, and adjusting quickly to the new climate will be key to survival and success.

and a speedy analysis of the contractual position, may ultimately save money.

In a series of upcoming articles Clyde & Co will examine the implications of such a dramatic fall in the price of crude oil. We will focus in on the impact for the global oil & gas industry as well as looking at the response from particular markets, regions or countries, taking in for example how price fluctuations in commodity markets interplay with the oil market, or the impact on insurers as countries vulnerable to a slump in crude prices edge closer to default.

Impact on short and long term agreements

Our experience is that a landscape such as the current one can create great pressure for principals and suppliers in relation to both short and long term agreements, and that circumstances may arise in which organisations throughout the supply chain take a commercial decision to walk away from contracts as a result of market conditions. This is particularly pertinent in the context of longer term agreements including rig agreements, Production Sharing Agreements (PSAs), service arrangements and sales / supply contracts. Decisions to walk away can occur when situations change quickly and unexpectedly, with many parties currently revaluating projects, and in some cases walking away without forewarning.

Such circumstances typically lead to a proliferation of legal disputes between parties and our indications are indeed that the volume of disputes between parties is currently increasing.

By way of introduction to this series of articles, we discuss below, at a high level, some basic measures parties should consider to assist themselves should contractual termination issues, such as those discussed in this article, arise.

Introduction to contractual termination issues

Should a party find themselves facing a contractual termination issue there are some basic points to consider at the outset which may help to put you in the best position possible. These include:

Conduct. Depending on the specific circumstances relating to the potential termination, it may be important not to delay unnecessarily in terminating, or to engage in conduct which could be seen as affirmation of the contract. Conversely, in certain circumstances parties may wish to avoid any suggestion of terminating the contract in order to preserve the maximum number of heads of claim.

Exposure. Clearly different factors come into play when looking at an extensive framework contract as opposed to a short term single contract. For example, in respect of production sales, there may be hedges in place which will reduce or increase losses upon termination.

Legal rights. If you are the potential terminating party, a close analysis of the termination provisions in your contracts will be required. There may be force majeure provisions, or certain circumstances under the contract in which you may terminate on a legitimate basis.

Contract formalities. Irrespective of which side of the coin you are on, it is important to consider if there are any particular formalities in the contract in respect of termination. For example, any time limits or notification

requirements.

Potential non contractual rights. It is also worth considering whether there are any legal rights under the applicable law of the contract that improve your position. For example, enhanced statutory force majeure rights.

Protection / mitigation. Assuming your contract has been terminated, are there any steps you should take to protect your position. For example, registering a protest or mitigating your losses by terminating ongoing arrangements / arranging alternative suppliers.

The bottom line is that each case will turn on its individual facts. However, a prompt response to a termination situation, and a speedy analysis of the contractual position, may ultimately save time and money.

If you have any questions on any of the topics raised in this update please speak with your usual Clyde & Co contact or email energy@clydeco.com

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