Risky business: Offshore drilling and using force majeure as an exit route

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Summary

A contract can be a long term commitment. Over the course of a contract, circumstances change. Force majeure clauses generally allow parties to allocate contractual risk, by limiting liability, excusing performance or providing for termination, if unusual or unfortunate circumstances arise. However, the recent case of Seadrill v Tullow reminds us that it is not all that easy for a party to seek to avoid obligations it has freely undertaken.

Seadrill v Tullow: the court’s finding

The court found that Tullow’s failure to fulfil its obligation to provide drilling instructions to Seadrill was caused by two matters: one a force majeure, the other not. The court held that the force majeure event must be the sole cause of the default. As such, Tullow could not rely on force majeure to excuse its failure to perform and ordered Tullow to pay Seadrill USD 254 million.

Force majeure: an exit route?

Tullow sought to terminate its contract with Seadrill for the hire of a drilling rig on the basis that the Government of Ghana had issued an order preventing the drilling of new wells in an area of water that was the subject of an offshore boundary dispute with its neighbour Cote d’Ivoire. Tullow said that this order was a “drilling moratorium” which was listed as a force majeure event in the contract.
Seadrill claimed Tullow terminated for convenience because it wanted to get out of a contract that had become less commercially attractive. Oil prices collapsed in 2014 which led to a reduced demand for rigs and a substantial reduction in the market rate for the hire of such rigs.

The court decided that there were two things that prevented Tullow from fulfilling its obligation under the contract to provide drilling instructions to Seadrill:

- The drilling moratorium (a force majeure event); and
- Tullow’s failure to progress, and the Government of Ghana’s failure to approve, a plan to drill wells in certain oil fields unaffected by the moratorium (not a force majeure event).

**Causation**

A party relying on a force majeure clause must generally show that a force majeure event occurred AND that it prevented or delayed its performance. The force majeure clause in question was no exception and provided that neither party was responsible for failing to fulfil any term or condition of the contract:

"if and to the extent that fulfilment has been delayed or temporarily prevented by an occurrence, as hereunder defined as FORCE MAJEURE."

The court, citing the Court of Appeal’s decision in Intradex v Lesieur [1978] 2 Lloyd’s Reports 509, interpreted this to mean that the force majeure event must be the only effective cause of default. The judge found that in this case, the force majeure event did not prevent Tullow from providing drilling instructions to Seadrill because the moratorium did not prevent Tullow from using the rig to drill in other oil fields unaffected by the moratorium.

**Reasonable endeavours**

A force majeure clause usually requires the defaulting party to show that it used its best efforts to prevent, or at least mitigate, the effects of the force majeure. Again, the clause in question was no exception:

"Both parties shall use their reasonable endeavours to mitigate, avoid, circumvent or overcome the circumstances of FORCE MAJEURE."
The court held, obiter, that even if the moratorium was the sole cause of Tullow’s failure to perform, Tullow had failed to exercise reasonable endeavours to avoid or mitigate the force majeure. Mr Justice Teare concluded that Tullow could not show that it had exercised its “reasonable endeavours” where there were opportunities to perform its contractual obligation but those opportunities had not been taken because they were more expensive or risked being unprofitable.

Tullow was entitled to consider its own commercial interests as to whether there was a business case for drilling outside the disputed area but it also had an obligation to consider:

- Seadrill’s interests; and
- Alternative ways to perform its obligations (for example by directing the rig to alternative permitted drilling areas).

**Contract more expensive to perform? Tough luck!**

As noted above, around the same time as the drilling moratorium, there was a fall in the market rate for hire of an oil rig. Tullow’s contemporaneous documents contained isolated references to a “Project Voldemort” which Seadrill alleged was Tullow’s plan to exit the contract given the falling oil prices and rig hire rates.

A contract being more expensive to perform is generally insufficient to qualify as a force majeure event. The courts are cautious of oil companies terminating a contract by way of force majeure when economic conditions mean that it is more expensive to perform and less commercially attractive.

**Conclusion**

The point to take away from this case is that parties negotiating long term contracts should consider whether to include a force majeure clause, or other provision, which modifies obligations or permits termination on the occurrence of a specified change in the economic climate. In addition, if you are hatching a cunning plan, don’t name it after Harry Potter’s arch-nemesis and one of the greatest villains of modern literature, because it will stick out like a sore thumb in disclosure.
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