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Liabilities: FLNG projects

FLNG projects are inherently high risk as they combine complex industrial processes, the bulk handling of cryogenic liquids, as well as the more conventional perils of the sea. Liability risks associated with LNG have been the source of much controversy, particularly in the "doomsday" scenario of a catastrophic explosion possibly caused by human error, containment or equipment failure or some form of hostile attack, be that kinetic or cyber in nature. It is, however, important to put such risks into context; in reality, the prospect of the risk which inevitably is a concomitant part of LNG construction, production or carriage actually materializing may not be as great as some commentators would suggest. LNG carriers and FLNG facilities are managed by very reputable and prudent businesses; LNG is in many respects no more hazardous than many other flammable and noxious cargoes, and the incident rate for LNG carriers is extremely low with no incidents resulting in significant spills of product. It may undoubtedly be the case that a major LNG carrier or FLNG incident could be catastrophic (and for that reason all involved should understand the extent to which such risks are covered by insurance), but it is important to note that the risks that do exist are typically very carefully analysed and managed by all those involved.

Offshore construction contracts commonly allocate the risk of personal injury (in a manner which is often dependent on who employs the injured person), damage to property (in a manner which is often dependent on who owns the property), pollution (in a manner which is often dependent on the origin of the pollution) and consequential losses. It would be beyond the scope of this article to address each, and instead this article focuses on the risk of damage to the FLNG facility itself during the construction phase and post completion.

There is currently no industry standard offshore construction contract for FLNG projects and it is not expected that one will ever be developed. Instead oil and gas companies are using the contracts that they have developed for FPSO projects as the starting point for FLNG projects. Each company has its own preferred form and there is therefore a range of wordings often providing for different levels of exposure to, and mechanisms for managing, risk.

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How liability is apportioned in respect of damage to a FLNG vessel under construction therefore varies. To some extent, a lack of a consistent approach is allowed to persist because the facilities under construction are typically covered by the same CAR policy that insures both the company and the contractors. Provided the CAR policy responds and funds the costs of repairing the damage, it may be thought to be of limited practical relevance as to which party would bear the loss. How liability for damage to the FLNG facility under construction is apportioned is, however, extremely important, as it may be that loss or damage is not (fully) insured. Whilst the standard CAR policy is reasonably comprehensive, there is no guarantee that it will respond in every circumstance. In addition, deductibles can be substantial, meaning that there could be significant uninsured exposure in any event.

Whilst there is no standard form, the LOGIC Offshore Construction Contract provides a useful reference point, particularly given that it was developed through collaboration between leading players from both sides of the industry (participants included Shell). Under the LOGIC form of contract, the risk of physical loss or damage to the facility under construction generally

rests with the contractor up until the time of completion (in other contracts sometimes referred to as provisional acceptance) when it passes to the company. Whilst the facility under construction is owned by the company, it is excluded from the scope of the indemnity given by the company for the company group's property. Further, the LOGIC Marine Construction Contract does not include any indemnity clauses in relation to the risk of physical loss or damage to the facility. Instead, subject to a number of express exceptions, it places responsibility for loss or damage to the facility prior to completion on the contractor. The express exceptions (in respect of which the company bears the risk) are:

(a) by War Risks as defined in the London Market Standard Fire Policy, or Nuclear Risks as defined in the London Market Standard Nuclear Exclusion Clause, and/or

(b) by any negligent act or omission of the company group, and/or

(c) by a force majeure occurrence.

Since the development of the publication of the Second Edition of the LOGIC Marine Construction contract form in October 2004, offshore construction contracts have transferred progressively more risk to the contractors. In our experience of FLNG projects, the extent to which contractors are being expected to accept the risk of physical loss or damage to the facility varies from project to project. By way of example:

1. The company may agree to accept the risk of physical loss or damage to the facility above a specified amount and may provide the contractor with an indemnity for any loss or damage above that amount. If this approach is adopted, it is common to see the contractor being made responsible for all losses below the defined amount irrespective of cause.

2. At other times, the risk of damage to the facility during the construction will be placed firmly on the contractor without any of the express carve outs found in the LOGIC form of contract. If appropriately drafted indemnity clauses are included this may even extend to allocating the risk of damage caused by the company's negligence to the contractor.

3. Sometimes the contracts do not provide for the transfer of the risk on completion of the facility but instead confirm that the issuance of a completion certificate is not intended to relieve the contractor from any of its obligations.

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In doing so it will take comfort from the Construction All Risks Insurance that the company will be obliged to procure for both parties benefit. Nevertheless, post completion many contractors would hope/expect that the risk of physical loss or damage to the facility should rest with the company. Post completion the contractor will have no rights and will therefore derive no comfort from the company's operating policy which insures the facility. In order to mitigate against the exposure to claims in respect of physical loss or damage to the facility post completion, contractors may seek to include an exclusion clause that bars any claims other than warranty claims post completion. Such clauses are common in shipbuilding contracts but are used inconsistently in offshore projects. Whether such a clause is included will of course be a matter for negotiation and will depend on the respective parties' bargaining positions.

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Where such a clause is absent the contractor will remain exposed to claims for loss and damage which arises from the contractor's breach of contract. By way of example, if three years after completion (or provisional acceptance) a loading arm cracked giving rise to a loss of product which might cause either structural damage to the ship and/or the FLNG vessel, or death and/or serious injury to personnel, and the crack was due to inappropriate materials or design, then the contractor could be liable for the loss. In such circumstances, the contractor would be left to fall back on any aggregate cap on their liability.

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