

Step-in, step-out; the contractual dance with the subcontractors

Everybody knows about the changing landscape in the shipyard market over the last decade and the drive to ever cheaper jurisdictions; it's all about cost. But it's all very well going cheap and building a handymax bulker in a yard no-one has heard of. In FPSO projects, where the cost can run into billions of dollars, the buyer company is likely to be more cautious. They will want top end expertise to make sure their highly complex units are built on budget and, crucially, on time.

So there's a friction. The buyer wants a new FPSO or (even more complicated) wants to convert an existing tanker, and wants a yard with the right pedigree to do the work. But, understandably given the oil price in recent times, they have to keep the cost down. The yard's view may well be that you get what you pay for.

The answer is, of course, subcontracting. EPIC contracts (and their variants) usually allow the contractor the right to subcontract substantial parts of their scope of work. In the more extreme examples, the contractor is effectively the manager of an army of different subcontractors. Managed properly, this can work well: each subcontractor is a specialist in its field and the resulting vessel is of a high quality. However, it can lead to disastrous situations when a contractor loses control of its subcontractors, leaving the project in jeopardy. If a subcontractor refuses to complete an essential part of the work, on the build's critical path, due to a dispute over scope of work or payment, then the whole project might stall. Even if the ultimate client does not terminate its contract with the company, the company can find itself liable for substantial liquidated damages for delay.

It is with these potential problems in mind that the buyer company may insist on step-in rights, i.e. the right for the buyer to step in to a part of the work to

execute it. However, although the company may need to step-in to ensure completion of part of the work, it may be reluctant or unable to take over all unfinished work. For that reason, the company may wish to include in the contract both step-in and step-out rights; i.e.: to allow the company to complete part of the work, whilst being able to oblige the EPIC contractor to complete the remainder and to satisfy the installation, and acceptance and commissioning requirements.

What is the scope of those rights and can they be exercised in practice? Take the example of a subcontractor whose role is fabrication. They are located in a low-cost jurisdiction, separate from that of the contractor yard. They are overwhelmed and quickly the schedule starts to slip. If the contractor cannot solve the situation, the company ultimately wants the right to step in, take the work as is, complete the job and then, crucially, step out again.

This sounds easy enough in theory, but in practice it is likely to be very hard. The subcontractor, who is unlikely to have been paid, may well use every means available to prevent the buyer taking away the work in whatever state it exists. Indeed, in some jurisdictions, this is going to be nearly impossible, regardless of what the relevant contract says.

And the contractor may also have concerns: what impact does the buyer stepping in and then stepping out again have on the warranty provisions in the EPIC contract? The company will insist on a reduction in the price for those works or seek an indemnity for all of the costs of the work; the contractor may well resist this. The yard may be prepared to accept more traditional step-in rights (i.e. the company comes and takes the FPSO away and finishes the whole project elsewhere) but they will be less keen on having to incorporate the company's work into their own scope of work.

Ultimately it will be a question of contractual negotiation and the answer will lie in a number of areas of the agreement. It may well never be entirely satisfactory but often the existence of step-in/step out

rights may be enough to improve the company's negotiating position, if a project goes off-track. In our experience, getting a project back on track is usually a matter of heavyweight negotiation, which is greatly assisted by the company having potent contractual remedies available, even if in practice the company would prefer a solution which avoids the need to implement those remedies.



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