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Cheaper oil - A bane for the offshore supply vessel industry

At the outset, here's wishing you and your family a happy, healthy and prosperous 2015.

The Offshore Supply Vessel (**OSV**) industry has seen significant growth in recent years. However, the steep fall in oil prices of late could put a spanner in the works for the OSV industry.

At present, global oil prices are in the middle of one of its steepest selloffs since the financial crisis of 2008/2009. World oil prices, which were hovering in the region of US$110 per barrel from January 2010 until mid-2014, have taken a nose dive since June this year so much so that as of 16 December 2014, prices of oil have almost halved.[1] This decline has shown no signs of abating and some analysts have even predicted that oil prices may fall below US$50 per barrel this year.

Whilst the decline in oil prices is likely to be a boon for consumers, the same cannot be said for the OSV industry. This is because oil majors are likely to cancel or delay their drilling operations and big ticket production projects which are predicated on high oil prices.[2] Evidence of this can already be seen in the recent announcement by ConocoPhillips that it would be cutting investment spending in 2015 by 20 percent.[3]

The potential reduction in drilling operations and production projects would be of particular significance to OSV operators (both Owners and Charterers). This is so as drilling operations are a key driver in the demand for the use of OSVs such as platform supply and anchor handling tug vessels. OSV operators are therefore expected to experience a fall in the demand for OSVs.

[1] http://www.theguardian.com/business/2014/dec/21/oil-price-fall-economics-russia-us-scotland-uk
[2] http://www.ft.com/cms/s/0/b3d67518-845f-11e4-bae9-00144feabdc0.html#axzz3Ncx8PRcZ
[3] "Oil Falls to 5-Year Low, and Companies Start to Retrench", The New York Times, December 9, 2014

Charterers seek to discharge themselves from charterparties

One possible repercussion of the fall in the prices of oil and the expected fall in demand for OSVs is that Charterers may seek to discharge themselves from charterparties which they had concluded prior to this decline. Such a trend was seen from the collapse of the freight market in 2008 which saw many charterers in the dry bulk industry attempt to discharge themselves from unprofitable charters.[4] Similarly, this trend is likely to be seen in the context of the OSV industry as Charterers would find that their charterparties have become significantly less profitable if the OSVs are unutilised as a result of the fall in demand. The need to discharge themselves from such unprofitable charters is also made more pressing by the fact that it is not uncommon in the OSV industry for Charterers to enter into long terms charters (e.g. 3 + 3 year term charters).

One possible argument that Charterers may advance to discharge themselves from an unprofitable charter is that the unexpected and severe drop in oil prices constitutes a supervening event that has frustrated the charterparty. The question then becomes whether the financial hardship suffered by the Charterers as a result of a decrease in the profitability of their charterparty constitutes a frustrating event. This question was considered by the Singapore Court of Appeal in ***Glahe International Expo AG v ACS Computer Pte Ltd and another appeal ('Glahe')*** which concerned a contract for the purchase of computers. In that case, the Appellant sought to argue that the contract had been frustrated as a result of severe inflation and currency depreciation which had made the contract less profitable. The Singapore Court of Appeal held that a mere change in profitability is not enough to frustrate a contract and that the obligations under

[4] http://incelaw.com/en/documents/pdf_library/strands/shipping/shipping-e-brief/shipping-e-brief-october-2011.pdf

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the contract must be fundamentally altered.[5] In light of the holding in ***Glahe***, it is unlikely that Charterers would be able to rely on the doctrine of frustration to discharge themselves from their charterparties. This is because whilst the increase in oil prices and the resulting fall in demand for the use of their OSVs may affect the Charterers' profit margin, it is unlikely to materially change their obligations under the charterparty.

Another way Charterers may seek to extricate themselves from unprofitable charters is through the invocation of *force majeure* clauses in the charterparties. Unfortunately, a decrease in the price of oil would seldom be expressly set out as an extraordinary event/circumstance that permits the invocation of a *force majeure* clause. That being said, *force majeure* clauses usually contain a catch all provision which permits parties to invoke them where there is an occurrence of "any other **similar cause** beyond the reasonable control of either party". Charterers may attempt to argue that the dramatic drop in oil prices constitutes a "similar cause" which would allow them to invoke the *force majeure* clause. However, in our view, such a construction is unlikely to be persuasive.

As can be seen from above, an argument based on frustration or *force majeure* may not be sustainable. To promote Charterers' interests it may be useful going forward to amend the *force majeure* clauses such that they expressly include a material change in the economic outlook of the charter. Such clauses must however be drafted stringently so that they can hold up to the court's/an arbitral tribunal's scrutiny.

Another way Charterers can discharge themselves from unprofitable charters is where Owners have become insolvent. In the present economic climate, this is not unlikely as Owners face underutilisation of their assets or rate reductions. One particular issue would be whether the insolvency of an Owner can be classified as a repudiatory event that entitles the Charterer to terminate the charter. In some of the more common charterparty forms for OSVs, such as SUPPLYTIME 2005, insolvency is expressly set out as an occurrence or event which would entitle either party to terminate the charter. In the absence of such a clause, however, Charterers would have to adduce clear evidence of an intention on the part of Owners not to perform their obligations under the charterparty so as to be able to terminate the same.

Charterers should note that upon termination, they will only have a right to claim in the liquidation, along with all the other potential creditors. They must therefore consider whether it would be more favourable commercially to try and maintain the charter, or whether they would rather terminate and attempt to recover in the liquidation.[6]

Consolidation and conclusion

A continued depressed price in oil may also lead to a consolidation of several OSV players. Smaller and newer OSV operators may not survive in this harsher economic climate and are likely to become targets of larger OSV operators with a healthy cash flow. For instance, Icon Offshore is currently looking at several merger and acquisition (**M&A**) opportunities with regional OSV players that are expected to materialise this year.[7] Likewise, we have also become more involved in several possible M&A transactions involving OSV players, details of which will become known in due course. We are also seeing an upsurge in newer types of OSV financing which include private equity or investor groups acquiring a vessel and then doing a sale and leaseback with the ultimate buyer.

Although the OSV industry is currently reeling from the slump in oil prices, a challenging market almost always presents opportunities. Clearly, this is now a buyer's market on the sale and purchase side and a charterer's market on the contracting side and players with a long term view of the market stand to benefit from these opportunities. After all, what goes down must eventually come up and it will be a matter of time before oil prices pick up and demand for OSV consequently rebounds.

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[5] Glahe International Expo AG v ACS Computer Pte Ltd and another appeal [1999] 1 SLR(R) 945 at [39]

[6] http://whoswholegal.com/news/features/article/15859/the-credit-crunch-impact-shipping-contracts

[7] http://themalaysianreserve.com/new/story/icon-offshore-talks-potential-mas