

PASSING OF TITLE AND RISK IN CONSTRUCTION CONTRACTS – SPOTLIGHT ON FPSO CONTRACTS

Introduction

Floating Production Storage and Offloading Vessels (FPSOs) are used for the production and storage of crude oil produced in shallow and deepwater fields located offshore. Unlike conventional ships, they are technical and are built based on the specifications and general conditions existing at the field where they are to be deployed.

Acquisition

FPSOs can be acquired outright or leased. Acquisition involves construction of a new FPSO or conversion of an existing VLCC (Very Large Crude Carrier). The project contracts are structured as either EPCI (Engineering, Procurement, Construction and Installation) contracts awarded on the basis of a turnkey project to a single contractor who will have overall responsibility or as separate contracts to several independent contractors, with the operator as the overall project manager. There are several contracts involved in the acquisition process and these include contracts for the design and engineering, construction or conversion of the hull and topsides, installation of the mooring systems, commissioning, operation and maintenance of the FPSO unit. The turnkey contractual mode allows the operator to transfer the project risks to the contractor, while the separate contract approach in theory, allows the operator to retain better control of the project while taking on almost all the project risks.

The Construction Contract

Construction involves the operator awarding a contract for the design and construction of the hull and process facilities. Contracts for the construction of the hull are based to a large extent on standard

shipbuilding contracts, which could be modified to suit the contracting needs of the parties. The contract for the process facilities on the other hand is usually negotiated based on the exigencies of the parties and the field to be developed. FPSO construction contracts are usually cross-border as the hull could be constructed in Asia, the topsides in Europe and final commissioning in West Africa. Depending on the contract mode adopted, the operator may be dealing with one or several contractor(s) and several companies will be involved in different aspects of the project with a lot of interfaces. It is therefore necessary to understand the risks and liabilities to be borne by each of the parties to the project. For instance, an FPSO project by Exxon Mobil for the development of its deepwater field located offshore Nigeria. Option 1: Contract for the development awarded as a turnkey project to Hyundai, which sub-contracts the topsides to Maersk Contractors and mooring systems to FMC. Option 2: Exxon Mobil contracts directly with Hyundai, Maersk Contractors and FMC. After completion of the hull at Hyundai's shipyard in Asia, while the unit is being towed to Maersk Contractor's yard in Europe for installation of the topsides, or after the topsides are skidded on the deck and while the unit is being towed to the AB field, it encounters heavy weather and is damaged. The ultimate liability will be borne by the party in whom the title and risk to the unit resides. The above example though extreme, reinforces the need for parties to familiarise themselves with the contractual risks associated with projects of this nature. This paper will consider when title and risk are deemed to pass in such contracts.

Nature of the FPSO contract - Sale/ Agreement to sell

The passage of title and risks will depend on the nature of the contract. Some doubt has been expressed over whether contracts for the acquisition of a FPSO unit can be regarded as a contract of sale or merely an agreement to sell. This is because at the time the contract is

executed by the parties, the FPSO is not yet in existence. In Nigeria, the legislation, which regulates the sale of goods is the Sale of Goods Act (SGA) 1893. Section 1 provides that where under a contract of sale the property in the goods is transferred from the seller to the buyer the contract is called a sale, but where the transfer of the property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is an agreement to sell.

Furthermore, section 5 provides that the goods, which form the subject of a contract of sale may be either existing goods, owned or possessed by the seller, or goods to be manufactured or acquired by the seller after the making of the contract of sale, called future goods. It is further provided that where by a contract of sale the seller purports to effect a present sale of future goods, the contract operates as an agreement to sell. From the above, it is clear that contracts for the acquisition of a FPSO unit is more likely to be seen as an agreement to enter into a contract of sale.

Passing of title and risk - Title

Section 18 of the SGA deals with the passing of title of future goods and provides that where there is a contract for the sale of unascertained or future goods by description and goods of that description and in a deliverable state are unconditionally appropriated to the contract either by the seller with the assent of the buyer, or by the buyer with the assent of the seller, the property in the goods and consequently, the risk passes to the buyer. In effect, by the provisions of the SGA, title to the unit passes when the FPSO is completed or the materials are so appropriated as to be regarded as part of the unit. This can create difficulties where the builder goes bankrupt or a receiver is appointed over the assets of the company, after payment is received in part but before the unit is constructed. In such a situation, the operator/buyer contractor may have to prove its claim along with other creditors,

unless adequate provision is made in the contract to avoid such occurrence.

Structuring the payment clause

In order to obviate the situations enumerated above, provision can be made for the property to pass in stages in the process of construction backed with a counter or performance guarantee by the operator/buyer contractor, to pay the instalments as and when they fall due. The payment can be tied to payment events divided into identifiable stages. A typical payment pattern could be:

Event	Payment (percent of contact price)
Signing of contract	5
Laying of the keel	5
Commencement of fabrication	10
30% steel erected	15
70% steel erected	20
Steel erection completed	20
Launch	10
Delivery	15
Total	100

However, very clear, specific and unambiguous words must be used in the contract to express the intention of the parties that the title to the FPSO unit should pass in stages as the goods or materials must be seen as appropriated to the unit, before title can be held to have passed. General words used in the contract have been held insufficient. In the English case of *Re Blyth shipbuilding & Dry Docks Company Limited* [1908] A C The Blyth Shipbuilding and Dry Docks Co agreed to build a ship for an Italian company. The contract provided for payment by instalments as the construction of the ship reached specified stages. Clause 6 provided that from the time the first instalment was paid, the vessel and all materials and things appropriated to the vessel were to

become the absolute property of the purchaser. Subsequently, the company got into financial difficulties and a receiver was appointed over the assets of the company. The vessel was partially constructed and two instalments had been paid. There was some material in the builder's yard, some of which had been approved by the buyer's surveyor for construction of the hull and others, which had not been approved. The question that arose for determination was whether the property in the partly built ship and material in the builders yard had been so appropriated to the vessel so as to be regarded as the buyer's property. It was held that the property in the material did not belong to the buyer because it had not become so inextricably part of the vessel as to be regarded as appropriated to the vessel. In addition, the unit can be made security for any instalment paid or a performance guarantee can be obtained from the construction contractor.

Passing of risk

The general rule is that risk passes with the property. Consequently once the property in the FPSO unit is held to have passed to the operator, the risk is also transferred. This could occasion injustice in situations where the unit is partially constructed and is destroyed, or the contract is frustrated. It is therefore advisable for parties to specify that the risk is not to pass until the FPSO unit is fully constructed and delivered to the field.

Conclusion

In conclusion, the importance of determining the stage at which title and risks are held to pass in contracts of this nature cannot be over emphasised as failure to anticipate potential risks and consequently make adequate provisions could greatly impact on the rights of the parties. The key to success is to ensure that the exact intention of the

parties is incorporated in the contract through the use of clear, specific and unambiguous words.

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