

AN OVERVIEW OF SERVICE CONTRACTS IN THE OIL AND GAS INDUSTRY

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1. Introduction

The exploration, production and development of oil and gas requires that certain technical services be performed over oilfield assets. Many of these services are outsourced to third-party contractors who perform them for a prescribed fee under an agreement known as an oil and gas service contract. Oil and gas service contracts are generally of two forms: pure service contracts and risk service contracts. These forms differ in their scope and, to some extent, in the possible parties that may enter into them.

Pure service contracts² are agreements for the provision of specific oilfield services, such as the acquisition of seismic data, drilling and construction.³ They are between an oilfield operator, who is usually an oil company, and the service contractor, who provides its technical service in exchange for a prescribed fee. Although this type of contract exists between an oil company and a host government, it is quite rare.⁴ These services form part of a broader oilfield exploration and development plan. Risk service contracts, however, encompass a broader scope of services than pure service contracts. Under a risk service contract, a host nation⁵ contracts with a (foreign) oil company to explore and develop its oilfield asset. The oil company assumes all managerial and technical responsibilities and bears all the financial and operational risks, in consideration for a prescribed fee.⁶ Risk service contracts represent the evolution of the contractual framework for oil and gas exploration and development, from the concession and production sharing contract models that granted the foreign oil company some interest over the oil.⁷ Under a risk service contract, the

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² These may otherwise be known as oilfield service contracts.

³ A Timothy Martin, *Model Contracts: A Survey of the Global Petroleum Industry*, 22 J. Energy & Nat. Resources L. 281, 299 (2015), <https://doi.org/10.1080/02646811.2004.11433373>

⁴ Betty Simkins and Russel Simkins, *Energy Finance & Economics: Analysis and Valuation, Risk & Management, and the Future of Energy*. (2013)

⁵ This party may also be a non-country holder of an oilfield asset who lacks the technical and financial capacity to develop the asset. However, this article will mostly refer to host nations, as the more popular operator party in risk service agreements.

⁶ A Timothy Martin, *Model Contracts: A Survey of the Global Petroleum Industry*, 22 J. Energy & Nat. Resources L. 281, 300.

⁷ Abbas Ghandi & Cynthia Lin, *Oil and Gas Service Contracts around the World: A Review*, March 2014 at 1,2. http://www.des.ucdavis.edu/faculty/lin/service_contracts_review_paper.pdf

service company is only entitled to a fee for services performed. Despite their differences however, both pure and risk service contracts are similar in that they are agreements for the provision of an agreed upon service in exchange for a pre-determined service fee.

This article will review both forms of service agreements, considering the contexts within which they are applicable and the major terms that are found in them.

2. Pure Service Contracts

Pure service agreements are contracts for the provision of specific technical oilfield services. These agreements stipulate the procedure and schedule for the performance of and payment for such services.⁸ Model contract forms are very popular with pure service agreements. While many oilfield operators and petroleum service organizations have their own standard form agreements,⁹ in practice, operators usually insist on using their own standard forms, which contain terms that are favourable to them,¹⁰ because they regard themselves as having the upper hand in negotiations.¹¹ Recently however, operators and service companies, through their respective representative industry organizations, have jointly published endorsed model forms.¹² The most important terms during negotiation are the payment terms and the allocation of risk in the liability and indemnity clause.¹³

The most common types of pure service agreements are seismic contracts, drilling contracts, well services contracts, master services agreements, design and construction contract, and procurement contracts. Model forms exist for each of these contracts, some of which may be peculiar to certain local and/ or international markets.¹⁴

Seismic contracts are agreements for the acquisition of seismic and geophysical data, which are used to determine drilling sites for oil and gas bearing structures.¹⁵ The International Association of Geophysical Contractors (IAGC), the Canadian Society of Exploration Geophysicists and the Association of International Petroleum Negotiators (AIPN) have each published their model forms for seismic acquisition contracts. Drilling contracts are agreements for the provision of drilling rigs, equipment and personnel for onshore or offshore operators. The International Association of Drilling

⁸ A Timothy Martin, *Model Contracts: A Survey of the Global Petroleum Industry*, 22 J. Energy & Nat. Resources L. 281, 301

⁹ *Id.* at 300. For the purposes of this section, a number of oilfield services agreements were reviewed including the model forms of the following organizations: Canadian Association of Petroleum Producers (CAPP), International Association of Drilling Contractors (IADC), the Norwegian Oil and Gas Association (OLF), Association of International Petroleum Negotiators (AIPN) and the Petroleum Equipment Suppliers Association (PESA).

¹⁰ Andrew R. Thomas, *Service Contracts in the Oil and Gas Industry*, Dec. 2013 at 1, http://levin.urban.csuohio.edu/epc/Education/NBI_Service_Contracts/NBI_Service_Contracts.pdf

¹¹ A Timothy Martin, *Model Contracts: A Survey of the Global Petroleum Industry*, 22 J. Energy & Nat. Resources L. 281, 300

¹² *Id.* At 301. An example of a joint operator and service company organization model form is the Seismic Acquisition and Well Services Model contract form by AIPN and PESA which was reviewed for this section.

¹³ *Id.*

¹⁴ *Id.* at 301-304.

¹⁵ *Id.* at 301

Contractors (IADC), the Canadian Association of Oilwell Drilling Contractors (CAODC), the American Petroleum Institute (API), and the Cost Reduction Initiative in the New Era (CRINE) have each published model form drilling contracts. Well services contracts provide for all the different ancillary services undertaken during an oil well drilling project. AIPN and PESA have jointly published a model well services contract. CRINE has also published model forms for the UK North Sea. Design and construction contracts provide for the onsite construction of oil and gas facilities that are used in oil production. Procurement contracts are used to purchase equipment that is transported to the site. CRINE has published model forms for design, construction and procurement contracts. An operator and a contractor may also enter into a master service agreement to govern their rights and obligations during the provision of any of these oilfield services over a long period.

Main Terms

Scope and Performance of Work

A pure service agreement will provide for the definition, scope and duration of the work to be performed. The work scope is usually delineated in attached schedules or exhibits and would state all the contractor's obligations including a detailed summary of the contracted operations, the list of technical reports and documentation to be prepared and submitted, and an inventory of the equipment to be maintained. In addition, term clauses may also provide for the operator's option to extend the term of the agreement, subject to its discretion. If the parties contract using a master service agreement, each service work order will provide for the list of services it contemplates.

Work performance will also cover each party's rights and responsibilities. The contractor is responsible to perform the work subject to the agreed standards, including a duty to be acquainted with the nature and scope of the work and all matters affecting it. The contractor is also obligated to perform the work in a timely fashion and in a professional and careful manner or a good and workmanlike manner. The 'good and workmanlike manner' standard requires that the contractor perform the services in a manner deemed proficient by persons having special knowledge, training and experience in those services. The contractor shall give priority to the safety and protection of life, health, property and the environment. The contractor is also generally responsible for obtaining any permits required for the performance of the work. Where the agreement is for the provision of seismic acquisition services, the contractor shall be responsible to prevent pollution and to clean up any resulting pollution from the work. The operator is responsible to provide the contractor with access to the area of operations, to inspect the work and to obtain any authorizations legally required to be obtained in its own name.

Payment Terms

A pure service agreement will provide for the contractor's compensation for the work done. If the parties have contracted using a master service agreement, each payment invoice will follow from

and provide for fees related to a specific service work order. Compensation may either be a fixed rate, which shall cover all the contractor's costs, expenses and profit for providing the work, or a periodic rate, i.e. an hourly, daily, weekly or monthly rate. The operator may also be liable for other costs such as mobilization and demobilization charges, installation charges, service and equipment costs and standby rates. The operator shall make payments in the currency and within the time specified in the agreement or be liable to any agreed late payment fees.

Payment clauses may also provide for the party responsible to pay any applicable taxes, i.e. whether they will be withheld by the operator or included in the contractor's fees and thus payable by the contractor.

Allocation of Risk, Liabilities and Indemnification

Allocation of risk clauses designate which party assumes the risk and liability for any damages resulting from the loss, damage or destruction to any equipment or the oilfield asset. This is the second major negotiation point after the payment terms.¹⁶ They cover the allocation of risk and liability for any damage to the contractor's or operator's equipment, the wellbore, any environmental pollution or contamination and any consequential damages. In certain instances, risk may pass from contractor to operator, subject to the parties' contractual arrangements. The liable party will also indemnify the other party for any claims arising from the risk activity. Liability may flow regardless of cause or may be limited to or exclude actions resulting from a party's negligence or gross negligence. The liability and indemnity clause will further require that each party retain liability for and indemnify the other party from claims arising out of personal injury, illness, death, property loss or damage suffered by any of their personnel, officers and affiliates, as well as damage to third parties attributable to such party.

These clauses are important to protect against protracted litigation resulting from disputes over fault.¹⁷

Warranties

Warranties are another major term in pure service agreements. While each party makes warranties regarding performance, most of the performance warranties are made by the contractor. The operator would generally warrant that it has legal and actual access to the work site. The contractor would warrant that he is qualified to and shall perform the work. Contractor may also choose to provide a service¹⁸ and/or a products warranty,¹⁹ to perform the services in a good and workmanlike manner and to provide products, equipment and materials that conform to published specifications, are free from defects and meet all technical specifications for such items required by any applicable

¹⁶ Andrew R. Thomas, *Service Contracts in the Oil and Gas Industry*, Dec. 2013 at 1.

¹⁷ *Id.*

¹⁸ The service warranty clause may also be called a warranty of performance.

¹⁹ The products warranty clause may also be called a warranty of goods.

laws, regulations, codes and standards. If the contractor provides for a service and/ or product warranty, such warranty is for limited period. Contractor's product warranty may expressly cover consumable products and rental items, that they shall meet the agreed specifications. Where the pure service agreement is for seismic acquisition, the contract would warrant that the work and seismic shall comply with the specifications and technical requirements provided for in the contract for the stipulated duration. The warranties clause would also provide for remedies for breach of warranty and the extent to which the contractor's liability is limited. Remedies for a product service warranty would include replacing or repairing the affected product or refunding the operator if it replaces or repairs such defective product. Remedies for a service warranty would include re-performing the defective service or refunding the operator if it re-performs such service itself.

Service agreements may limit each party's warranty and the remedies for breach to only those expressed in the agreement. Where warranties are limited to those expressed in the agreement, no implied warranties, including warranties for merchantability, fitness for purpose, satisfactory quality, or other implied conditions of contract law, would apply. However, some indemnity clauses extend indemnity protection to any damage resulting from a breach of any express or implied representation or warranty. The contractor may also make no warranty as to the accuracy or usefulness of any data, reports, conclusion, interpretation, or advice it provides the operator and the operator would acknowledge that it uses such information at its sole risk.

Insurance

An insurance clause is a regular feature in pure service agreements. Both the operator and the contractor would be required to procure and maintain throughout the duration of the agreement some minimum insurance as required by the laws of the country of operations where the work is to be performed including workers' compensation insurance, commercial general liability insurance and automobile liability insurance. The minimum insurance coverage is limited to the amount specified in the contract. The insurance clause may also include provisions for excess liability insurance, hull insurance and liability insurance for vessel and/ or aircrafts where applicable. Each party is also required to obtain a waiver of its rights of subrogation against the other party on all the insurance policies required under the contract.

Subcontractors

Subcontracting is very commonplace in the oil services business²⁰ and is a common clause in pure service agreements. Contractors may only subcontract any part of the work upon receiving the prior written approval of the operator, which may not be unreasonably withheld. Subcontracts are not binding on the operator and the operator's approval does not relieve the contractor of any of his contracted obligations and it is responsible for all acts, omissions, and defaults of the subcontractor.

²⁰ Andrew R. Thomas, *Service Contracts in the Oil and Gas Industry*, Dec. 2013 at 1, 2-3.

Breach, Default and Termination

A contractor's delay or defect in performance will result in a breach of contract. An operator's failure to make timely payments also amounts to a breach of contract. The agreement may also contain other listed actions the occurrence of which would result in either the contractor's or operator's default. These actions usually include events of insolvency, bankruptcy and receivership against party, any contractually unauthorized assignments or transfer of any rights or interests in the agreement, and any breach of a provision which directly and adversely affects the work or the performance of any party's obligations.

The remedies for breach or default may include damages, compensation for direct losses suffered as a result of the breach, the requirement for the defaulting party to repair or rectify the breach, or the suspension and/ or termination of the agreement. Termination clauses may also grant the operator the right to terminate the contract at its convenience. In the event of termination, the contractor is entitled to compensation for the performance through the date of termination, as well as any direct and non-recoupable costs reasonably necessitated by the termination.

Other terms – Governing Law and Dispute Resolution, Force Majeure, Assignment, etc.

Pure service agreements also include boiler plate terms such as the governing law applicable to the contract and the form of dispute resolution that they will be bound by, the rules that govern events of force majeure, assignment, amendments, waivers, confidentiality and other general provision terms.

3. Risk Service Contracts

Risk service contracts differ from pure service contracts because they are wider in scope and usually involve the exploration and development of an oilfield asset. Through these agreements, a host nation, lacking the technical capacity to develop its oilfield assets, contracts with an oil company to develop the asset, in exchange for a service fee. In this regard, a risk service contract is comparable with a production sharing contract. However, unlike under a production sharing contract, the oil company under a risk service agreement contracts for a pre-determined fee instead of sharing in profit oil.²¹ The oil company also has no interest in the crude produced and jointly operates the field with the host nation. Unlike pure service contracts which guarantees that the contractor or oil company will receive its fees whether there is oil production or not, risk service contracts provide no such guarantee. Where the exploration activities result in no commercial discovery, the contractor or oil company will not be paid.²² Since these agreements are usually with countries, there are no

²¹ Abbas Ghandi & Cynthia Lin, *Oil and Gas Service Contracts around the World: A Review*, March 2014 at 1, 4.

²² Talal Abdulla Al Emadi. *Joint Venture Agreements in the Qatari Gas Industry: A Theoretical and an Empirical Analysis*. (2019)

applicable model forms. Each country has its standard form risk service agreement with clauses that may be peculiar to each country.

Non-country oilfield operators may also enter into risk service agreements with other companies that have the technical and financial capacity to assist in developing the asset.

Main Terms

Scope of the Contract

The scope of the contract clause expresses the quantum of the work to be done under the agreement. The work to be done is generally designated as petroleum operations, which is a defined term under the contract, involving the exploration and production of petroleum in the oilfield area. The contractor/ risk service provider will provide technical, financial and operational services to the host nation/ oilfield operator. In the provision of these services, the risk service provider assumes all exploration risks and will not be entitled to reimbursement of expenses incurred if no petroleum in commercial quantities is discovered. The risk service provider is usually bound to perform the work according to contractually agreed standard, which may either be good or best international petroleum practice standard or good oilfield practice standard.

Rights and Obligations of the Parties

The risk service provider will be obligated under the agreement to perform all petroleum operations and provide all the necessary services, technology and financing in connection with the operations. It is contractually bound to act diligently, safely and efficiently, in accordance with good oilfield practices and international petroleum conservation principles. It must, at its own expense, access the oilfield, provide adequate technical personnel for work activities and train the staff of the host nation/ operator. The risk service provider is also bound to perform the work in accordance with the specified timeline in the work program. It is subject to the provisions of all applicable laws relating to labour, health, safety, and the environment and may also be required to procure and maintain insurance in the name of the operator/ host nation.

The risk service provider is also entitled to all the rights detailed in the agreement, including any specified tax and other legal exemptions, any agreed upon risk service provider fees, and the right to enter and exit the oilfield area and other specified facilities at all times.

The oilfield operator may also have obligations under the agreement, especially where it is a company and not a country. These obligations may include such duties as the duty to obtain all relevant licenses, perform any joint activities under the agreement, permit the RSP unrestricted access to the oilfield area and provide any relevant and/ or agreed upon data and reports to the risk service provider. Such reports may include any technical, geological, reserves engineering, commercial, legal or other information relating to the oilfield and its operation agreement.

Minimum Work Obligation

Host nation risk service agreements provide for minimum work commitments which list the minimum obligations for each sub-phase of the work program that the risk service provider must fulfil within the specified timeframe and for the specified expense amount. These obligations involve the performance activities related to the work, such as wells drilling and rehabilitation, and building necessary oilfield, and oil and gas gathering, treatment and transportation facilities. Substantial failure to perform the minimum work commitments in a timely fashion may be grounds for termination.

Development Plans, Work Programs and Budgets

Risk service agreements usually establish a joint management committee, which is made up of persons nominated by the host nation/ operator and the risk service provider, to supervise and control petroleum operations. The risk service provider is responsible to this management committee in the performance of the work. It must prepare and submit to the management committee the relevant development plans, as well as any revisions, and make annual submissions of a detailed work program and budget. Any development plans, work programs or budgets must be approved or endorsed by the host nation, through its oil ministry or its state oil company, before it is approved by the management committee. The risk service provider must then conduct petroleum operations in accordance with the approved work program and budget.

Risk Service Provider Fees

In consideration for the services provided, the risk service provider is entitled to recoup its operating expenses and receive a service fee. Such fees may be in the form of cash, calculated based on the formula specified in the agreement. Instead of cash payments for fees, the risk service provider may be entitled to an economic interest in the petroleum produced. Fees and expenses may be contingent on discovering oil in commercial quantities and in such instance, will be paid out of the sale, exchange or disposal of the petroleum.

Other Terms

Risk service agreements also include other clauses such as term and termination, transfer and assignment, governing law and dispute resolution, and intellectual property, tax and force majeure.

4. Conclusion

Service agreements form an integral part of the business of oil and gas production and development. This article has reviewed both forms of oil service agreements that apply in the oil and gas industry and has considered the contexts within which they would apply. It has also discussed the relevant

clauses of both forms of oil services agreements, especially noting the duties and benefits each party may be entitled to under the contract.