

MEMORANDUM OF (MIS) UNDERSTANDING: PITFALLS OF A SUBSEQUENT AGREEMENT ON AN UNDERLYING CONTRACT

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Where problems arise in oil and gas contracts, it is not uncommon for the parties to seek to address those problems arising under the original contract with a subsequent, modifying agreement.

The Technology and Construction Court in *HSM Offshore BV v Aker Offshore Partner Limited* [2017] EWHC 2979 (TCC) has considered the interaction of one such modifying 'Memorandum of Understanding' ("MOU") with the original contract. In the dispute that subsequently arose regarding final payment for the contract works, it emerged that neither party had achieved quite what they bargained for.

Background

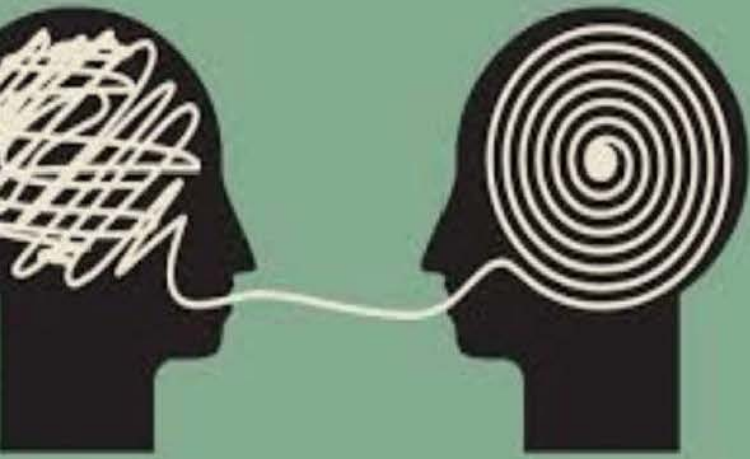
Aker Offshore Partner Limited ("Aker") engaged HSM Offshore BV ("HSM") to carry out the fabrication of two process modules, for use on the Clyde Platform in the FlyndreCawdor oilfield in the North Sea.

The contract between Aker and HSM (the "Contract") incorporated LOGIC subcontract conditions, and contained a list of key milestone dates to be met by HSM, including "module ready for Sail Away" (the "RfSA date"). The RfSA date was to be 10 May 2015.

However, the project encountered problems and it became apparent that the RfSA date would not be met. To get the project back on track, HSM and Aker agreed the MOU, which was dated, and intended to have effect from, 18 March 2015. The MOU provided that "In return for HSM utilizing their fullest endeavours to complete Mechanical

Completion for Process Modules M12 and M14 on or before July 1st 2015 HSM will receive the following concessions against the CONTRACT." The various concessions included a change to the way in which HSM was remunerated. Under the MOU, HSM was also required to produce a revised programme for the project, which listed 19 July 2015 as the revised RfSA date.

Sail Away eventually occurred on 10 August 2015. Soon thereafter, a series of disputes relating to almost every aspect of the Contract arose, although only certain of these were eventually heard by the Court. In particular, HSM sought to recover sums it claimed were outstanding under the MOU, and argued that Aker had no entitlement to review invoices previously approved by them. Meanwhile, Aker disputed those claims and launched a counterclaim for liquidated damages due to the delayed RfSA.



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The RfSA date and Liquidated Damages

The first issue before the Court was the effect of the MOU on the RfSA date and the liquidated damages provisions within the Contract.

Under Clause 35 of the Contract, HSM was to be liable to Aker for liquidated damages if it "fails to complete any of the items listed in [a separate Appendix] in accordance with the relevant date included in the SCHEDULE OF KEY DATES". The Appendix set liquidated damages for "delay to the Module completion and ready for Sailaway date" at €150,000 per day, up to a maximum liability of €1,500,000.

Aker claimed liquidated damages under the Contract. It contended that if the MOU had any effect on the RfSA date, it was to extend it to 19 July 2015, which date HSM had not met. HSM, meanwhile, argued that the MOU had the effect of removing a binding RfSA date altogether.

Was the original RfSA date of 10 May 2015 still in effect? The Court concluded, in light of the factual matrix and the circumstances leading to the MOU, that it was not. After all, "[b]oth parties knew that the 10 May 2015 date would not be achieved. Indeed, that was why the MOU had come into being in the first place." It would not therefore make sense for the MOU to retain a contractually binding RfSA date of 10 May 2015.

If 10 May 2015 had been displaced, had a new RfSA date been agreed? The Court found there was no express RfSA date in the MOU, and the date contended for by Aker (19 July 2015) did not have any contractual effect, being merely a "hoped-for date to which everyone was working."

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Further, the Court found that the MOU removed a binding RfSA date from the contractual framework, and with it any entitlement to liquidated damages. The Contract contained an absolute obligation to achieve Sail Away by a certain date, whereas the MOU replaced that with an obligation to use "*fullest endeavours*" to achieve a different stage (Mechanical Completion) which was not absolute. The MOU did not make any mention of sanctions for failing to do so, nor (as pointed out, oddly, by Aker) did it "*even refer to RfSA or liquidated damages*". The MOU obligation to use "*fullest endeavours*" was contradictory to the Contract obligation to achieve RfSA by a fixed date, and so obviously superseded it.

In those circumstances, provided HSM utilised their "*fullest endeavours*", they would not be in breach of contract, let alone liable for liquidated damages, regardless of when Mechanical Completion or RfSA actually occurred.

Estoppel and payment of invoices

The second issue before the court was whether monthly invoices rendered by HSM, and approved, certified, and paid by Aker, could be subject to later review or otherwise disputed. HSM argued that Aker were estopped from disputing that the invoice sums were properly due.

The Court completely rejected this argument – giving no less than five 'short' reasons for doing so, along with one 'long' reason that considered the full factual evidence of the invoice approval process. The clearest of those reasons was found in the terms of the Contract itself. Clause 17.9 of the Contract expressly stated that "*the COMPANY may correct or modify any sum previously paid*" where a sum was incorrect or not properly payable, and that "*[n]either the presentation nor payment or non-payment of an individual invoice*" constituted a waiver of any right. Interestingly, the judgment gives some insight as to why such an unsuccessful estoppel argument arose at all. In the course of the trial, witnesses for HSM suggested that the MOU had the result of making the contract a fully reimbursable one. However, this understanding was incorrect: although the MOU did make changes to specific elements of HSM's remuneration to a 'cost plus' basis, those individual changes were identified in the MOU. The MOU did not otherwise change remuneration under the Contract. As a result of this, it was apparent that large parts of HSM's invoices – amounting to some €20m – now disputed by Aker, might not be properly payable under the express terms of the MOU. The estoppel argument therefore only arose "*because HSM belatedly realised that the MOU did not say what [they] wanted it to say.*"



Conclusion

The arguments made (and lost) by both parties demonstrate the importance of ensuring that parties do not lose sight of the impact of an agreement made part way through performance of a project, often with a view to expediting or incentivising completion, on the underlying contractual position.

It is not unusual for 'issues' to arise during a project and for the parties to alter their agreement in order to get the project back on track. However, as this case arguably shows, if the parties are not clear as to how the terms of the subsequent agreement link back to the original contract, there is the risk that parties may unintentionally alter contractual entitlements and/or obligations – as both HSM

and Aker found out. Therefore, care must be taken by contracting parties to ensure that the full picture is understood by those involved in negotiating and drafting the terms of the modifying agreement in order to ensure that the ramifications of the amendment are fully considered and understood.

Rather than an *ad hoc* MOU, as was agreed in this case, it is preferable for parties to capture any changes they may wish to make in an amendment agreement, drafted in a way which clearly sets out those terms of the original contract that are to be affected. Of course, this can involve more detailed drafting at the time than parties valuing speed might prefer – but should assist in avoiding costly misunderstandings.

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