

Client Alert

May 2020

Indonesia: Reacting to COVID-19 in the Oil & Gas sector

For more information:

Norman Bissett
Foreign Legal Consultant
+62 21 2960 8678
norman.bissett@bakermckenzie.com

Nadia Soraya
Partner
+62 21 2960 8541
nadia.soraya@bakermckenzie.com

Stephen Clugston
Counsel (Tokyo Office)
+62 21 2960 8598
stephen.clugston@bakermckenzie.com

The energy, mining and infrastructure sectors continue to be impacted by COVID-19. The road and pace to full recovery is unclear. Oil and gas companies have been particularly affected by the reduction in demand, more so than many other industries, given their high cost base, technical and plant health, safety, and environment (HSE) requirements requiring ongoing spend, a glut in oil supply, and significant storage constraints.

In theory, oil and gas companies are particularly susceptible given the highly fragmented nature of their supply chain in which the majority of sector expertise, outside of the technical, planning and procurement areas, is outsourced. The position with respect to COVID-19 in South East Asia is not as advanced as China (whether in terms of impact, recover, or potential second waves). In any event, oil and gas companies across South East Asia, including in Indonesia, are seeking to clarify what contractual rights are (or may become) available.

In this alert, we expand on what was discussed on the recent conference call covering tips for oil and gas transactions in the current global market ([link](#) to summary) and briefly reflect on some of the issues oil and gas companies should consider under standard production sharing contracts (PSCs), joint operating agreements (JOAs), LNG sale and purchase agreements (SPAs), service contracts, and statutory obligations. This reflection is speculative given that right and obligations in respect to force majeure require a detailed contractual review. Furthermore, every company is subject to a different fact matrix as a result of COVID-19.

Force majeure provisions under oil and gas contracts are easier to read than they are to apply, at least correctly. Establishing whether a force majeure trigger event exists is only part of the battle. There is a need to make a proper analysis of causation in terms of disruption or impact of performance under the relevant contract. Please refer to our [Beyond COVID-19: Resilience, Recovery & Renewal](#) for a more in-depth analysis into the various issues being raised by COVID-19. In particular, for:

- a broad consideration of the impact of COVID-19 on the oil and gas industry, please click [here](#);
- a global guide to force majeure and international commercial contracts, please see our summary [here](#); and



- comparative analysis of force majeure in 37 jurisdictions, please click [here](#).

Putting the technical legal considerations aside, parties reaching for the force majeure (in the belief they have a right to make a claim) need to also think broadly and strategically about the impact of trying to make a claim under their oil and gas contracts and whether in fact, there may be better options with longer term benefits. We discuss these considerations below (from a general international law perspective).

Specific oil and gas obligations

Production Sharing Contracts (PSCs)

Many PSCs contemplate a conventional definition of force majeure, as an event or circumstance:

- beyond a party's control;
- that is not due to a party's fault or negligence; and
- which affects the continuation of operations - economically or otherwise.

PSCs may expressly include references to quarantines or epidemics as a force majeure event, making the task of identifying a relevant trigger under the contract an easier one (although the issues we flag above should still be considered).

Typically, if plant operations are curtailed, delayed or prevented due to a force majeure event, then the period of time for carrying out the obligations under the contract (that have been affected) will be extended, along with the related rights and liabilities and the term of the PSC.

Yet, despite such generous provisions, we are not seeing a wave of force majeure claims under PSCs. There are a number of potential explanations. These include the fact that:

- oil and gas operations in most jurisdictions, would seem to be permitted to operate on a 'business as usual' basis (albeit with further social distancing) as they are often deemed 'essential services';
- the key obligations under a PSC (at least post-exploration) involve work commitments; government counterparties seem to be willing to renegotiate these; and
- once in production phase, operational workforce requirements may be relatively lighter and more flexible. Therefore, there is a query as to the depth of impact that COVID-19 has on the ability to operate physically.



Joint Operating Agreements (JOAs)

The definition of a force majeure event under a JOA will generally follow the definition in the underlying concession.

Some JOAs based on AIPN model drafting often define a force majeure as circumstances beyond the reasonable control of a party that could not have been avoided or mitigated by foresight, planning, and implementation consistent with generally accepted practices of the international petroleum industry. These may include strikes, lockouts, and other industrial disturbances even if they were not beyond the reasonable control of such party.

With respect to the operator under a JOA, legally enforced social distancing measures that impact the operator's ability to carry out operations or to procure supplies and services, would seem to fit easily into the definition of force majeure.

As is often the case under project documents, force majeure does not typically extend to a paying party's inability to pay (i.e. payment obligations are not excused). So far as the funding of capex or opex commitments is concerned, swings in oil price might arguably be reasonably foreseeable and therefore not captured by a force majeure provision.

In any event, it might be difficult to see under what circumstances parties might seek to declare force majeure under a JOA. Assuming there is alignment among the parties, we would instead expect parties to agree to take steps to mitigate unnecessary expenditures and jointly seek to renegotiate commitments with government authorities – at least, this is what we are seeing in practice.

LNG Sale and Purchase Agreements (SPAs)

Typical force majeure definitions are relatively 'standard' and might include any acts or events that:

- are beyond the reasonable control of the non-performing party;
- prevent the non-performing party from performing its obligations under the SPA; and
- which the non-performing party has been unable to avoid or overcome by the exercise of due diligence.

However, a typical force majeure provision will also include a long list of specific exclusions, giving greater certainty, but at the same time, narrowing the scope and opportunity for a force majeure claim being brought. Typical exclusions would include:

- insufficiency of funds where a party has payment obligations;
- economic or market circumstances such as economic hardship, any change in any market or demand for LNG, natural gas, electricity, or any other product, commodity or service;



- commercial circumstances such as the ability of buyer or sellers to obtain better economic terms for LNG from an alternative supplier or buyer, respectively; or
- any change in law occurring after signing of the SPA, or change in interpretation or application of existing law that does not prevent performance, but merely renders it more costly.

At a cursory glance, these exclusions might seem to apply to prevent a buyer from claiming force majeure. However if, as a result of social distancing, the buyer is unable to offtake LNG (with the offtake clearly being identified as an obligation), then this may create an ability on the part of the buyer to suspend performance. Likewise, if storage capacity constraints prevent a buyer from accepting delivery, this might not fall clearly within the category of force majeure exclusions.

Increasingly, new LNG SPAs provide some downward flexibility and diversion rights. This may provide some temporary respite. Given current LNG prices (including collars and caps), however, we would expect to see ongoing pressure to explore force majeure remedies.

Service Contracts

Standard service contracts are generally prescriptive with respect to force majeure provisions and only allow a relatively limited set of force majeure events to be declared. These are unlikely to include pandemics, but might include natural disaster, acts of God, or changes in laws and regulations.

However, a government may endorse (or enforce) social distancing in response to COVID-19. If so and compliance with the relevant law or regulations impedes the provision of services under the contract, there is a compelling argument that the service contractor might be able to rely on a change in law force majeure to excuse its non-performance.

As to whether or not an oil and gas company will be able to claim force majeure in the context of enforced social distancing is less clear as the primary obligations relate to payment. That said, if the oil and gas company is not physically able to operate the site due to social distancing requirements, this may constitute a force majeure event.

Statutory and Regulatory Obligations

Whether or not force majeure arguments can be used to suspend business activities, very much depends on the relevant permits and licenses and their governing statutes and regulations.

PSCs and concession agreements may refer to force majeure provisions on some level, however, in reality, most PSCs and concession agreements do not comprehensively set out the relevant terms prescribed by statute or regulation.



www.hhp.co.id

HHP Law Firm
Pacific Century Place, Level 35
Sudirman Central Business
District Lot. 10
Jl. Jenderal Sudirman Kav. 52-53
Jakarta 12190
Indonesia

Tel: +62 21 2960 8888
Fax: +62 21 2960 8999

To the extent the agreements are silent (or do not comprehensively address) the matter, there is a risk that the terms of the relevant permits and licenses (or more so, the relevant statutory and regulatory obligations) will apply - although we have also seen the contrary position being argued as. Accordingly, in our view, PSC force majeure provisions may not be sufficient to create a defense for non-compliance and a thorough analysis of the underlying permits and governing regulations must be carried out.

In many (if not most) countries, oil and gas business activities have been classified as 'essential business activities'. Social distancing regulations do not typically differentiate between business sub-categories. Accordingly, the prudent would seem to be to comply with legal social distancing requirements at first instance. A detailed review of operation and business permits and licenses (and governing regulations) would be required to see to what extent these may justify suspending operations, or otherwise obtaining a temporary dispensation.

To claim or not to claim

Force majeure, although relatively easy to define, can be difficult to establish in practice. Companies should review and understand in detail, not only contractual rights but facts and circumstances (ideally, documented) to identify with clarity and certainty whether a force majeure claim may be available. As noted above, of particular importance is whether based on their circumstances, there is evidence of the causal link between the relevant event and non-performance.

Oil and gas companies need to fully understand the consequences of claiming force majeure and exercise due care, as an unsuccessful attempt to claim force majeure can be materially detrimental. An analysis should be carried out to fully assess the consequences of prolonged force majeure and any counterparty termination rights, as well as other remedies available under contract in the context of force majeure. Likewise, while in the context of a pandemic there is reflex temptation to 'reach for the force majeure clause', these should be cautiously (and carefully) considered in the context of any other alternative mechanisms available under contract.

In doing so, there is a need for broader commercial and strategic thinking in terms of the economic pressure a force majeure claim might put on other contract counterparties and what (if any) broader relationship impact this may have. Depending on the circumstances, parties may benefit more from jointly resolving (whether through amendment, waiver, or other joint agreement) the challenges caused by COVID-19, taking into account future working relationships or opportunities.

Given the above, claiming force majeure in the context of oil and gas contracts should be viewed tactically and potentially as a precursor to discussions around cost reduction and other opportunities to 'share the pain' – bearing in mind, that sometimes the solution is not always found in the contract.