The future of quantity surveyors in the upstream oil and gas industry

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HSM v Aker and the untapped potential of the QS

IN response to the oil price crash of 2014, the upstream oil and gas industry implemented drastic cost reductions. These were implemented on a wide scale through practices including overhead reductions, lean working, adoption of efficient technologies and discount seeking across supply chains. It is estimated that these practice improvements have achieved reductions to operating costs of up to 30%.[1]

The oil price has since recovered to higher levels. At the time of writing this article, the benchmark price for Brent Crude was in the $70-80 per barrel range.[2] Investments in oil and gas developments have also seen an increase, with some $300bn expected to be spent on new developments throughout 2019 and 2020.[3] This is estimated as being equal to the total costs expended through the three years across 2015-2017. It remains to be seen whether oil companies can maintain their lean cost models or whether increased investment will result in increased costs, as has happened in previous cycles. For quantity surveyors working in the industry this raises the question as to how they can best contribute to maintaining these reductions.

The industry is global in scale and comprises many different lifecycle phases throughout a range of physical environments, both onshore and offshore. These include aspects from exploration and drilling, infrastructure development, production operations and decommissioning and encompass a variety of working methods with varying support requirements and skills. The size and scale of the industry often results in highly process-driven organisations requiring specialised skills in particular areas. As a result, it is common to find groups of professionals focusing on niche skills and competencies, as opposed to more generalised working practices. In turn there are numerous professional groups and institutions working with the industry to establish best working practices in their specific fields. Some of these professions also perform work that quantity surveyors traditionally practise in.

Professional institutions such as the Chartered Institute of Procurement and Supply (CIPS) and the Association of Cost Engineers (ACostE) are two such examples, and both work closely with the industry. Members of these institutions can be found in significant numbers working within oil and gas companies. Both institutions and their members are well respected in industry for the work they perform.

For quantity surveyors practising in the industry, the combination of highly process-driven practices and their shared competencies with other professionals can result in the specific need for quantity surveyors being diminished (if compared to construction and civil engineering, for example). For quantity surveyors active in the industry it is therefore useful to establish which of the QS skills and competencies add most competitive value and demonstrate the highest benefit to the industry. Specialised skills that are not obviously replicated by other professions are particularly relevant.

Core competencies

Core QS competencies such as measurement, contract practice, commercial management and quantum valuation of works are good examples of specialised skills. It is also useful to note that contracting strategies in the industry are similar to those in construction and civil engineering, and therefore the competencies should be easily transferable. Coupled with suitable experience, the skills and competencies of the QS can easily be applied to

[1] Daniel Cole and Robert Harris-Deans, Preserving the Downturn's Upsides, March 2017 www.mckinsey.com/industries/oil-and-gas/our-insights/preserving-the-downturns-upside

[2] For the month of July 2018, the average price of Brent crude was circa $75 bbl, source www.rigzone.com

[3] Dan Murtaugh, After $80 Billion Blowouts, Mega Oil and Gas Projects are Back, 14 August 2018 www.bloomberg.com/news/articles/2018-08-14/after-80-billion-blowouts-mega-oil-and-gas-projects-are-back

projects and support services work, such as pipelines, fabrication of structures, offshore installation and hook-up, modifications and maintenance, and decommissioning.

The QS profession needs to continue to make this case and advertise these skills if it is to continue to make an active and lasting contribution to the industry. This will require the continued work of quantity surveyors practising in the industry supported actively by their professional institutions. The case will continue to be made as to how the profession can meet the needs of the industry and identify areas where the profession can create even further value.

The industry has a particularly mixed reputation with respect to managing works strictly in accordance with contracts and meeting budgets. Therefore, the role of the QS in managing projects from post-contract award through to completion (including dispute resolution where disputes cannot be avoided) should be an area of potential value generation. Due to the high cost of projects in the industry, the potential savings to be gained from more evenly applying QS competencies in contracts, measurement and valuations could be significant. Within the industry there are numerous anecdotal stories of oil companies adopting policies of quick and easy settlement negotiations rather than protracted final account negotiations or formal disputes. Whilst many of these stories are likely to have been exaggerated, quantity surveyors practising in the industry are likely to have witnessed this type of activity at some level. This being the case, it does indicate that there is further scope for quantity surveyors with experience in the industry to assist in improving this situation.

It's easy for the profession to make such bold claims but more difficult to provide actual evidence to support them. Case studies are therefore useful where available, in so far as they clearly support the role of the QS in reducing costs. Reference to relevant litigation, having the added advantage of being publicly available, can provide a particularly useful source. Cases related to final account disputes in the industry that touch upon the role in which quantity surveyors played

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in reducing project costs are therefore a valuable commodity to those championing the profession.

HSM v Aker

An example of such a case arose in *HSM Offshore BV v Aker Offshore Partner Limited* (2017) EWHC 2979 (TCC). This case was, at its heart, a final account dispute whereby the parties disagreed over final payments due to the module fabricator. Whilst other issues such as the application of liquidated damages were also addressed, the case was predominantly focused on issues of quantum and the principles of measurement and valuation.

Aker engaged HSM to fabricate two process modules for installation on the Clyde Platform in the North Sea (UK Continental Shelf). The contract between Aker and HSM incorporated LOGIC contract conditions for construction, with the remuneration principles being primarily remeasured against a bill of quantities (BoQ). During the course of the works, various problems arose and the parties agreed to modify the principles of remuneration, the basis of this agreement being captured in a memorandum of understanding (MoU). In a change to the contract remuneration principles of remeasurement against the BoQ, the MoU introduced compensation based upon reimbursable hours or cost-plus mark-up for certain cost headings.

During the remaining course of the works a series of interim payments was made to HSM. These payments were based upon information provided by HSM, including supporting documents including summaries of hours expended and copies of invoices relating to numerous third-party costs. Payments were made quickly following interim applications, allowing little time to carry out thorough checks of the supporting information.

Following completion of the work, HSM submitted its final account for the whole of the work. This final account was valued upon the cumulative value of interim payments made throughout the work, plus additional costs identified through close-out. Aker disagreed with this principle and produced a measured final account valuation, based upon its interpretation of the measurement rules in the contract and the MoU. Aker calculated from this that HSM's final account was overvalued and that the interim payments had been overpaid. HSM disputed Aker's final account valuation and also its right to recover any amounts that were claimed to have been overpaid.

The court was asked to decide whether Aker was entitled to revisit the interim amounts previously certified and paid or whether it was estopped from doing so. The court rejected HSM's estoppel argument and maintained that Aker was entitled to revisit the final account. This was supported by the contract and specifically the inclusion of LOGIC clause 17.9 stating that *"the COMPANY may correct or modify any sum previously paid."* Therefore, neither the presentation nor payment of an invoice waived this right.[4]

HSM relied upon its estoppel argument and as such chose not to perform any further re-measured valuation. It also argued that the MoU did not require it to produce a re-measure, although its witnesses did confirm that there was no technical reason preventing it from doing so. Since HSM did not feel it was necessary to produce a re-measured final account, it did not challenge the re-measure performed by Aker in any serious detail.

The absence of a re-measured final account made it difficult for the court to understand the basis of HSM's claims. This was exacerbated by the fact that since HSM was not advancing a re-measured valuation, it did not call an independent expert quantity surveyor to talk through the quantum issues and to assist the court. It was duly noted that *"the absence of independent quantity surveyors on either side was a grievous loss to comprehension and clarity."*[5]

As the estoppel argument failed and in the absence of any alternative re-measure by HSM, Aker's valuation effectively stood unchallenged. This resulted in a significant reduction against the final cost of the module previously submitted by HSM (of some 15% against the claimed final account value). Whilst this case turned primarily on the legal principles of estoppel, the facts surrounding the case with respect to interim payments and final account production are enlightening nonetheless.

Overall, the case provides a good example of the use of the benefits of utilising solid QS competences in the management of projects and their benefits to the industry. The production of measured valuations and the application of solid contract practice is vital in fully informing companies as to amounts that are actually due. This information is critical for ensuring that final accounts are settled in accordance with the contract terms and in a manner that is fully auditable. Where disputes arise, the work performed by quantity surveyors will also be essential in advising the legal team as to the basis of the claims and assisting in the formulation of evidence.

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Had Aker also chosen to forgo the production of a measured valuation, then the outcome of the case would have been quite different. Without a measured valuation to work from, the full extent of the possible claims might not have been identified in the first instance. Even if Aker understood that the final account being claimed was excessive, since it couldn't expressly demonstrate by how much, the matter would no doubt have been settled through some loose bargaining. There can be no doubt that the net result of this would be a premium being paid over and above the allowable contract principles. For an industry looking to maintain its achieved reduced costs, a strategy of negotiated settlements will not suffice.

Although in this case no independent QS expert evidence was heard, it was still noted that QS evidence can be invaluable in clearly explaining matters of quantum to a tribunal. This is high endorsement indeed. It demonstrates the skills and competencies of the QS profession as well as the further use of quantity surveyors as experts in such cases. Logically, if the courts value the quantity surveyor's abilities so highly when acting as experts on quantum, then this applies equally when the same quantity surveyor's expertise is applied during the project phase. The industry can only benefit from taking note.

Significant potential

It is clear that there is a significant potential for the development and use of quantity surveyors in the oil and gas industry – both throughout project lifecycles and beyond into the settlement of disputes. The profession itself should not take this for granted however, and needs to continue to demonstrate its effectiveness in minimising costs and providing value. If the profession is to succeed in this endeavour it is vital that both QS practitioners and the institutions representing them continue to engage with the industry and maximise awareness globally.

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[4] This is a particularly useful ruling for quantity surveyors practising in the industry and dealing with LOGIC contracts and bespoke contracts applying similar express terms, although it is still good practice to ensure that interim certificates and payments made on account are clearly identified as such

[5] *HSM Offshore BV v Aker Offshore Partner Limited* (2017) EWHC 2979 (TCC) para. 170