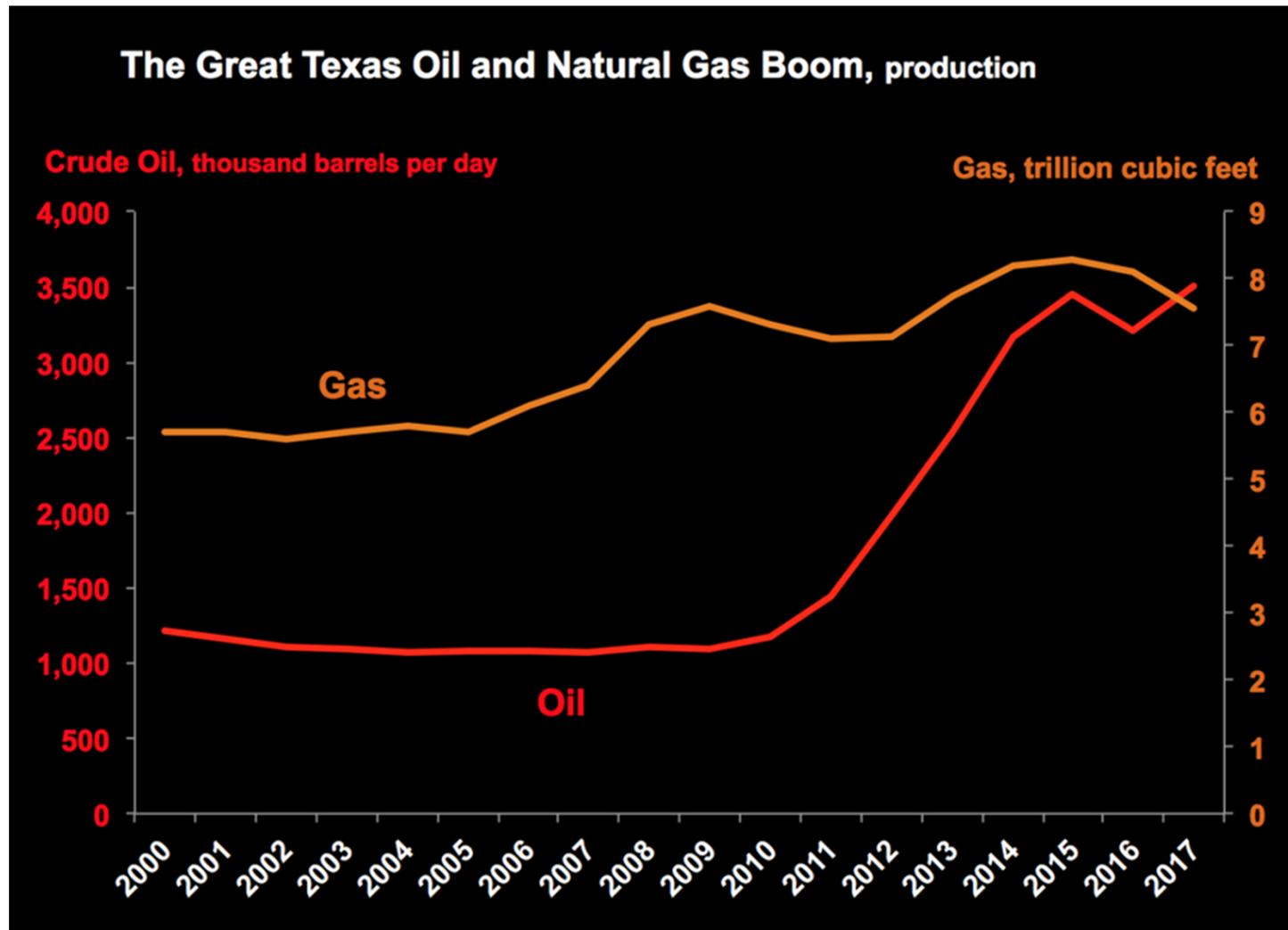


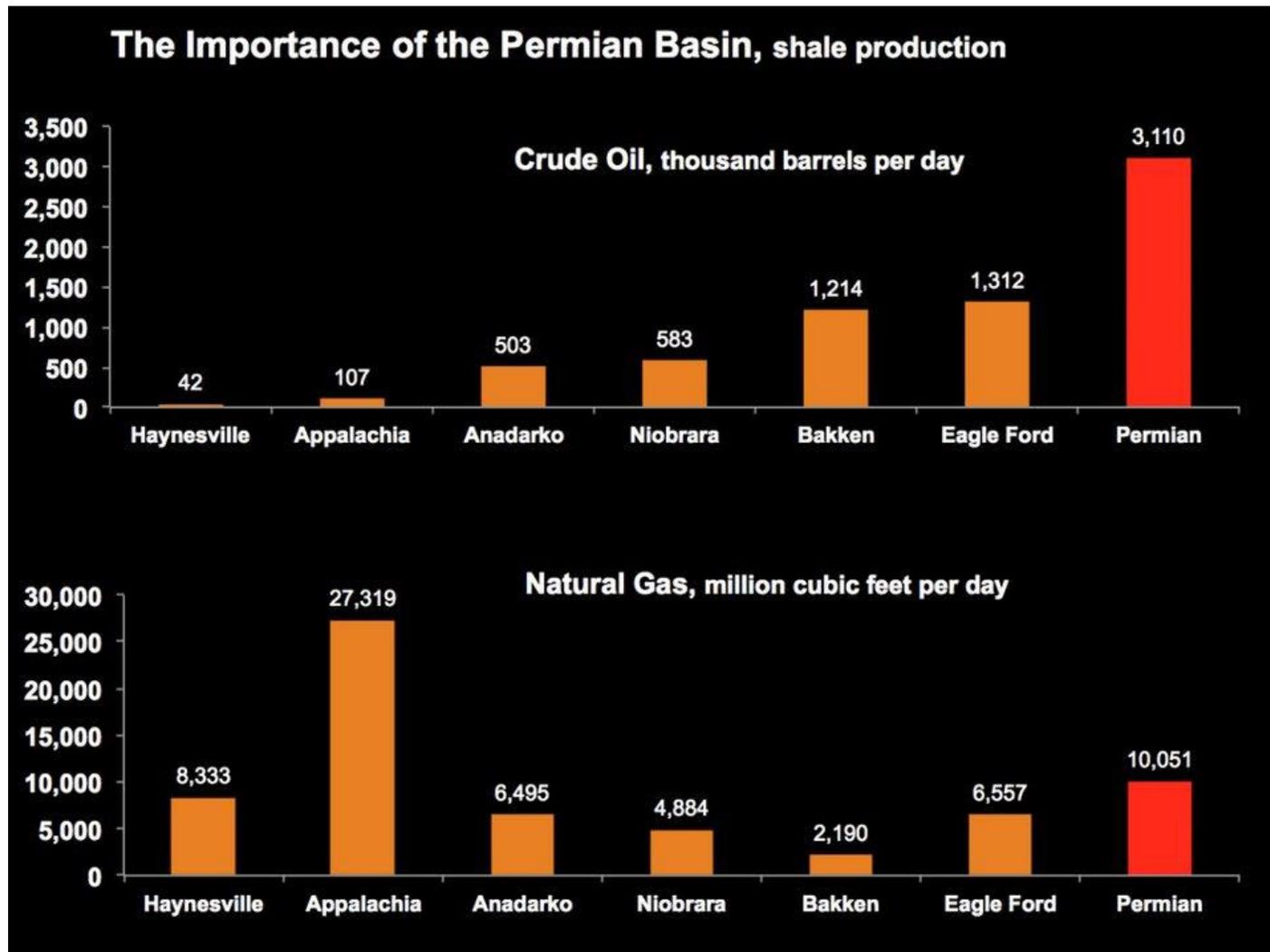
CONSTRUCTION IN THE OIL PATCH NAVIGATING LIEN AND INDEMNITY ISSUES

Amy K. Wolfshohl
awolfshohl@porterhedges.com

Jacqueline Moy
jmoy@porterhedges.com



SURGE OF PRODUCTION IN THE PERMIAN



What a difference a few years make

January 2017:

- Rig count: ~270
 - Had previously dropped to 134 in mid-2016
- Crude oil: ~2.1 million bpd
- Natural gas: ~7.5 Bcf/d

3d Qtr 2018:

- Rig count: 492, on 11-14-18
- Crude oil: ~3.6 million bpd
- Natural gas: ~12.0 Bcf/d

EIA Drilling Productivity Report

Baker Hughes Rig Count, as reported by Odessa American: In The Pipeline

RBN Energy, Hell in Texas – A New Drill Down Report on Permian Gas Takeaway Constraints and Their Effects

Recent headlines:

“Permian Water Disposal A Thorn In Our Side, Oil Execs Say, Michelle Casady,” *Law360*, Oct. 11, 2018

“Permian Producers Have a Power Problem,” Tsvetana Paraskova, *Oilprice.com*, Oct. 3, 2018

“Hell In Texas - A New Drill Down Report On Permian Gas Takeaway Constraints And Their Effects,” Housley Carr, *RBN Energy, Inc.*, Aug. 3, 2018

“Hotel Fractionation - Far-Reaching Impact Of The Unprecedented Shortfall In NGL Fractionation Capacity,” Housley Carr, *RBN Energy, Inc.*, Sept. 17, 2018

From Production... to Pipelines... to Processing... to Refineries and Petro-Chem Plants...

- Oil and gas rigs
- Electricity infrastructure and transmission grids
- Water treatment facilities and disposal wells
- Acid disposal wells
- Gathering and transportation pipelines, terminals
- Crude oil stabilization facilities
- Gas processing facilities
- NGL fractionation facilities
- Tank storage
- Crude oil processing facilities

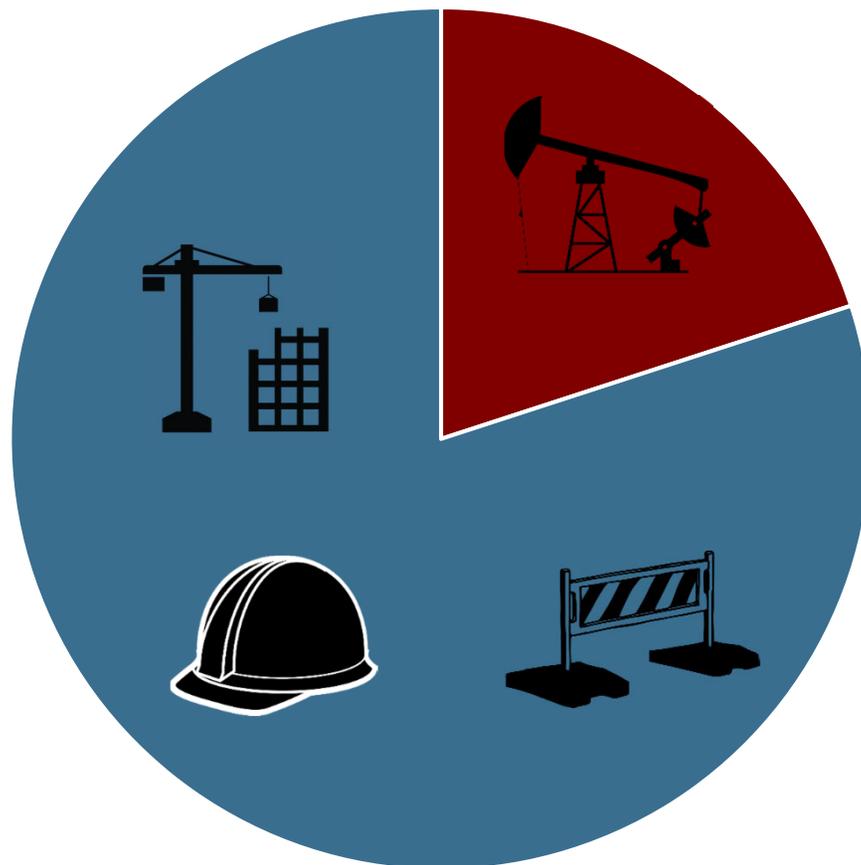
Lien Statutes

- Mineral Liens
 - Tex. Property Code Ch. 56
- Mechanic's Liens
 - Tex. Property Code Ch. 53

Anti-Indemnity Statutes

- Texas Oilfield Anti-Indemnity Act
 - CPRC Ch. 127
- Texas Construction Anti-Indemnity Act
 - Tex. Insurance Code Ch. 151
- Texas CPRC Ch. 130

LIEN STATUTES



■ Mineral Liens ■ Mechanic's Liens

Mineral Liens for Mineral Activities

- A mineral contractor/sub has a lien for labor or services relating to mineral activities
 - Digging, drilling, torpedoing, operating, completing, maintaining, or repairing an oil, gas, or water well, an oil or gas pipeline, or a mine or quarry.

Mechanic's Lien for Construction

- Labor and material provided for construction or repair in Texas of a:
 - Building or improvement
 - Levee/embankment
 - Railroad
- If they contracted with the owner:
 - A/E for plat/plans
 - Landscaping
 - Demolition

- Exclusive when applicable
 - “Chapter 56 is the exclusive statute governing liens against mineral property to secure payment for labor or services related to mineral activities. Persons entitled to liens under this statute are not entitled to liens provided by other statutes.” *Noble Expl. v. Nixon*, 794 S.W.2d 589, 597 (Tex. App.—Austin 1990).

Mineral Liens for Mineral Activities

“digging, drilling, torpedoing, operating, completing, maintaining, or repairing an oil, gas, or water well, an oil or gas pipeline, or a mine or quarry.”



Not All Oil & Gas Activities Are Mineral Activities



➤ Closer calls

- Demolition of a pipeline?
 - Is demolition digging, drilling, torpedoing, operating, completing, maintaining, or repairing?
 - **No.** Three Welding Equip. v. Crutcher, 229 SW2d 600 (Tex. 1950).
- Pipeline that carries naphtha or ethylene?
 - “oil” and “gas” are not defined in Ch. 56
 - No cases under Ch. 56
- Acid gas injection well?



Crude Oil Storage



Gas Processing Facility



Refinery

- How do the different types of liens affect risk on energy projects?
 - Retainage
 - Fund trapping
 - Bonds
 - Deadlines

Statutes Relating to
Mechanic's Liens



Statutes Relating to
Mineral Liens



- Owners of construction projects can be liable for mechanic's lien claims of any tier of subcontractor if:
 - **Retainage** is not withheld in the amount of **10%** of the general contract for 30 days after final completion [Tex. Prop. Code 53.101]
 - An owner pays a general contractor after receiving a pre-lien notice with **fund trapping** language [Tex. Prop. Code 53.084]

- Purpose is to create a fund for the benefit of subcontractors, not to ensure the contract is appropriately completed
- Retainage of 10% should be withheld even if:
 - There are multiple “original” contractors
 - The contract does not provide for retainage
 - The contract is time and materials (T&M)
- Ch. 53 compliant payment bond is the only way to avoid withholding retainage [Tex. Prop. Code 53.202]

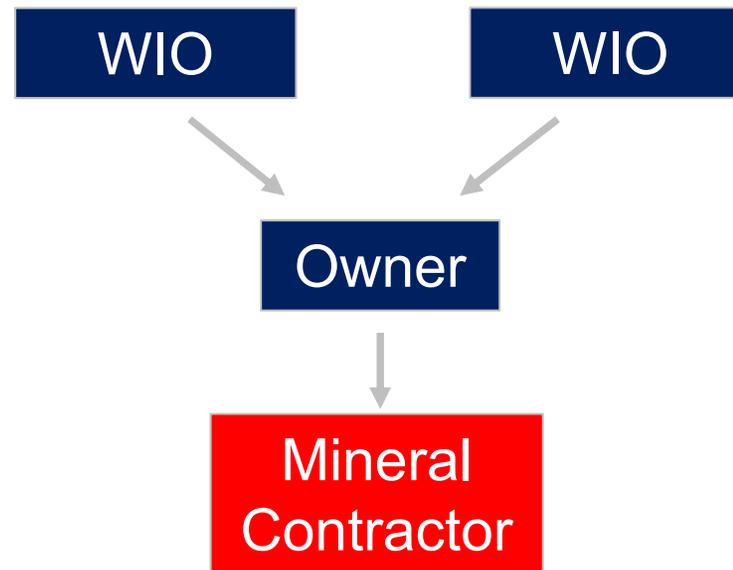
- If the owner fails to withhold retainage, the subcontractor lien claimants have a lien against the owner's property for at least 10% [Tex. Prop. Code 53.105]
 - Meaning that retainage funds that should have been withheld could be paid twice
 - On a \$100 million contract, the owner could have \$10 million in exposure for failing to withhold retainage
- When an owner fails to retain 10% for 30 days after final completion the claimant is not required to file an affidavit within 30 days of completion.

- No requirement to withhold 10% under Ch. 56

- Contract Drafting Tip: what should you require in the construction contract if you're not sure whether the work at issue would be subject to mineral or mechanic's liens?
 - Require 10% retainage

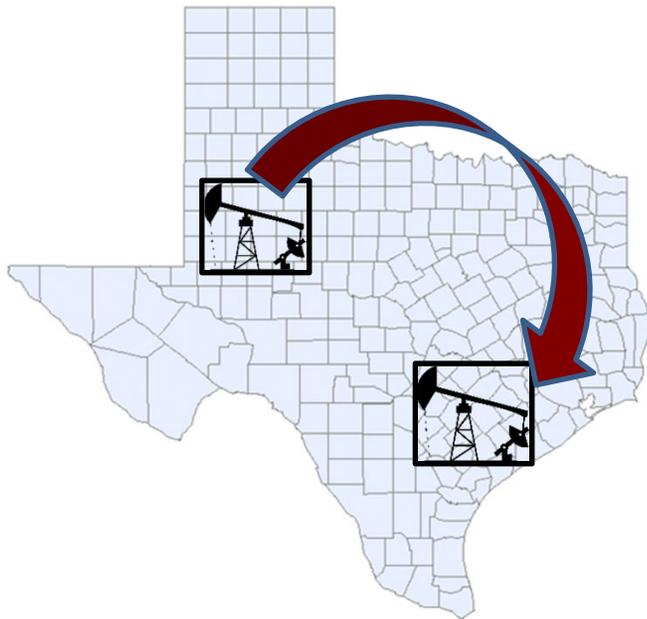
- No payment bond option under Ch. 56
- Will a Ch. 53 payment bond protect an owner against mineral liens?
 - Chapter 56 is “exclusive” method to perfect a lien
 - Mineral liens can affect more than one owner
 - Mineral lien can follow property [Tex. Prop. Code § 56.024(a)]
- Consider a letter of credit from the contractor to protect against risk of liens on mineral lien projects
- Not sure whether Ch. 53 or 56 applies?

Multiple Mineral Property Owners For the Same Mineral Activities



*Bandera Drilling Co. v. Lavino, 824 S.W.2d 782, 784
(Tex. App. – Eastland 1992, no writ)*

Mineral Liens Can Follow the Property

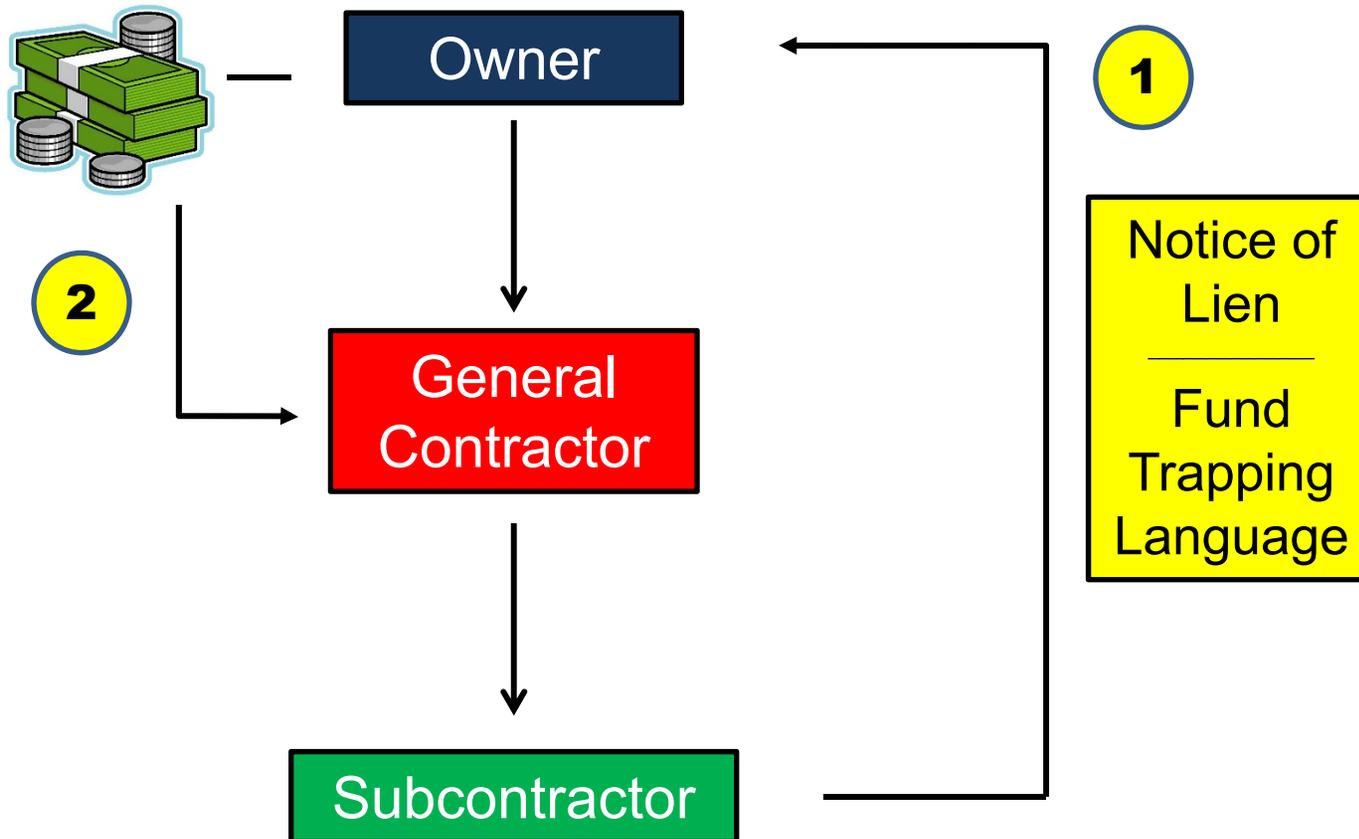


- File itemized inventory of the property showing the unpaid amount due;
- No later than the 90th day after the property was removed; and
- Mineral lien attaches to all property subject to the lien located in the county where the inventory is filed.

➤ What is fund trapping liability?

- Lien liability from an owner to a subcontractor for any amounts that should have been “trapped” by the owner (*i.e.* not paid to the GC)
- Results from an owner paying money to the general contractor after getting a pre-lien notice that includes funds trapping language without retaining the trapped amount

FUND TRAPPING LIABILITY



Page 2
April 3, 2018

NOTICE OF LIEN CLAIM

Re: Claims of Dragon Products, PES, Inc. ("Claimant") for unpaid billings to Trailhead Engineering, LLC

Dear Ladies and Gentlemen:

Our firm represents Dragon Products PES, Inc. ("Claimant") with respect to unpaid billings

This notice is sent in compliance with the Texas Property Code mechanic's lien provisions, including Section 53.056. Accordingly, we must notify you that **if this claim totaling \$125,537.79 remains unpaid, the owner of the premises may be personally liable and the owner's property may be subjected to a lien unless:**

- 1. The owner withholds payment from the contractor for payment of the claim;**
or
2. The claim is otherwise paid or settled.

may be subjected to a lien unless:

- 1. The owner withholds payment from the contractor for payment of the claim;**
or
2. The claim is otherwise paid or settled.

Also, further notice is hereby given that past due and unpaid billings constituting this claim have accrued and are past due. Accordingly, demand for payment of such claim in the amount of \$125,537.79 is hereby made.

- “Fund trapping” under Ch. 56?
- Under Tex. Prop. Code 56.043
 - A property owner who is served with a mineral subcontractor’s notice “**may**” withhold payment to the contractor in the amount claimed
- Practice tip:
 - If you’re not sure whether the lien is subject to Chapter 53 or 56, withhold the funds claimed by the lien notice if funds are in your hands
 - What you should do next is heavily dependent upon which statutory scheme applies.

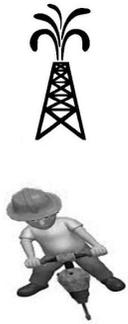
Deadlines

- Ch. 53 deadlines are incredibly complex
 - Handout
 - Generally - 4 months
 - after each month the work was performed for a subcontractor
 - after the end of the work for the original contractor
 - Additional notice requirements for subcontractors
 - Different retainage deadlines

- Ch. 56 deadlines are less complex and longer
 - Generally, 6 months from the end of the work [Tex. Prop. Code 56.021]
 - Notice required for subcontractors

Mineral Lien Deadlines

Mineral Contractors and Subcontractors



6 MONTHS



File Mineral Lien



Serve Pre-Lien Notice

10 DAYS



Mineral Subcontractors

- Does the strategy change due to the deadline for filing liens?
 - For potential lien claimants
 - Keep both deadlines in mind
 - You cannot file a lien too “early”
 - Towards the end of projects, it is even more important not to wait 4-6 months
 - If you’re uncertain which statute applies, comply with both
 - For owners
 - Once you’ve paid the contractor 100% on a mineral lien project, there is no further liability. [Tex. Prop. Code 56.006]
 - Unclear which statute applies – withhold retainage funds for 30 days after final completion

INDEMNITY

- Seeking indemnity for negligence of the indemnitor is always enforceable under anti-indemnity statutes
- Must also consider “express negligence” rule
- Unless a clause complies with the express negligence test and is conspicuous, indemnity for an indemnitee’s negligence is not enforceable
- Texas courts have held that allegations, not findings of negligence, are enough to invalidate an indemnity clause
 - *Fisk v. Constructors*, 888 S.W.2d 813 (1994)
- Bottom line: Always make sure your indemnity obligation complies with the express negligence rule to take advantage of statutory exceptions to anti-indemnity prohibitions

Texas Oilfield Anti-Indemnity Act

TEX. CIV. PRAC. & REM. CODE § 127.001 *et seq.*

- The Texas Oilfield Anti-Indemnity Act (“TOAIA”) generally provides that an agreement to indemnify a person for his own negligence is void as against public policy.
- TOAIA originated from the perceived bargaining inequities between big operators and generally smaller oilfield services contractors.



- TOAIA is limited in two important respects:
 - It applies only to certain contracts.
 - It allows for indemnification of an indemnitee for the indemnitee's own negligence if certain conditions are met relating to insurance.

Texas Oilfield Anti-Indemnity Act Applies To:

- Agreements pertaining to a well for oil, gas, or water, or to a mine for a mineral. §127.003
 - i.e., agreement concerning the rendering of well or mine services or an agreement to perform a part of those services or an act collateral to those services, including furnishing or renting equipment, incidental transportation, or other goods and services furnished in connection with the services. §127.001(1)
 - Does NOT include JOAs. §127.001(1)(B)

Texas Oilfield Anti-Indemnity Act Applies To:

“well or mine service” includes:

- drilling, deepening, reworking, repairing, improving, testing, treating, perforating, acidizing, logging, conditioning, purchasing, gathering, storing, or transporting oil, brine water, fresh water, produced water, condensate, petroleum products, or other liquid commodities, or otherwise rendering services in connection with a well drilled to produce or dispose of oil, gas, other minerals or water, and
- **designing, excavating, constructing, improving, or otherwise rendering services in connection with a mine shaft, drift, or other structure intended for use in exploring for or producing a mineral.**

§127.001(4)(A)

Texas Oilfield Anti-Indemnity Act DOES NOT Apply To :

“well or mine service” does not include:

- purchasing, selling, gathering, storing, or transporting gas or natural gas liquids by pipeline or fixed associated facilities, or
- **construction, maintenance, or repair of oil, natural gas liquids, or gas pipelines or fixed associated facilities.**
 - What about water pipelines?



§127.001(4)(B)

Texas Oilfield Anti-Indemnity Act DOES NOT Apply To:

- personal injury, death, or property injury resulting from radioactivity;
- property injury that results from pollution, including cleanup and control of the pollutant;
- property injury that results from reservoir or underground damage, including loss of oil, gas, other mineral substance, or water or the well bore itself
- personal injury, death, or property injury that results from the performance of services to control a wild well to protect the safety of the general public or to prevent depletion of vital natural resources; or
- cost of control of a wild well, underground or above the surface

§127.004

TOAIA Insurance Exceptions:

- TOAIA does not apply to an agreement that provides for indemnity if the parties agree in writing that the indemnity obligation will be supported by liability insurance coverage to be furnished by the indemnitor subject to the following limitations:
 - Mutual indemnity obligation: limited to the extent of the coverage and dollar limits of insurance
 - Unilateral indemnity obligation: the amount of insurance required - may not exceed \$500,000

§127.005

Mutual Indemnity Obligation

“...an indemnity obligation in an agreement pertaining to a well for oil, gas, or water or to a mine for a mineral in which the **parties agree to indemnify each other and each other’s contractors and their employees** against loss, liability, or damages arising in connection with bodily injury, death, and damage to property of the respective employees, contractors or their employees, and invitees of each party arising out of or resulting from the performance of the agreement.”

§127.001

Dollar limits of insurance

- The amounts of insurance required of each party under the contract need not be equal, but the indemnity obligation will be limited to the amount of insurance that is actually equally provided.
- If one party provides more insurance than the other, each party's indemnity obligation will be limited to the lower amount of insurance actually provided.

See Ken Petroleum Corp. v. Questar Drilling Corp., 24 S.W.3d 344 (Tex. 2000).

Extent of indemnity coverage

Obligations will be enforceable only to the extent that they are reciprocal. In *Ranger Ins. Co. v. American Int'l Specialty Lines*, one party ("Party A") indemnified the other party ("Party B") for gross negligence, but Party B indemnified Party A for only simple negligence. Relying on *Ken Petroleum*, as well as the savings clause in the contract, the court held that the indemnity obligation was enforceable, but only up to the extent of coverage the parties both agreed to provide in equal amounts, i.e., simple negligence.

78 S.W.3d 659 (Tex. App.—Houston [1st Dist.] 2002)

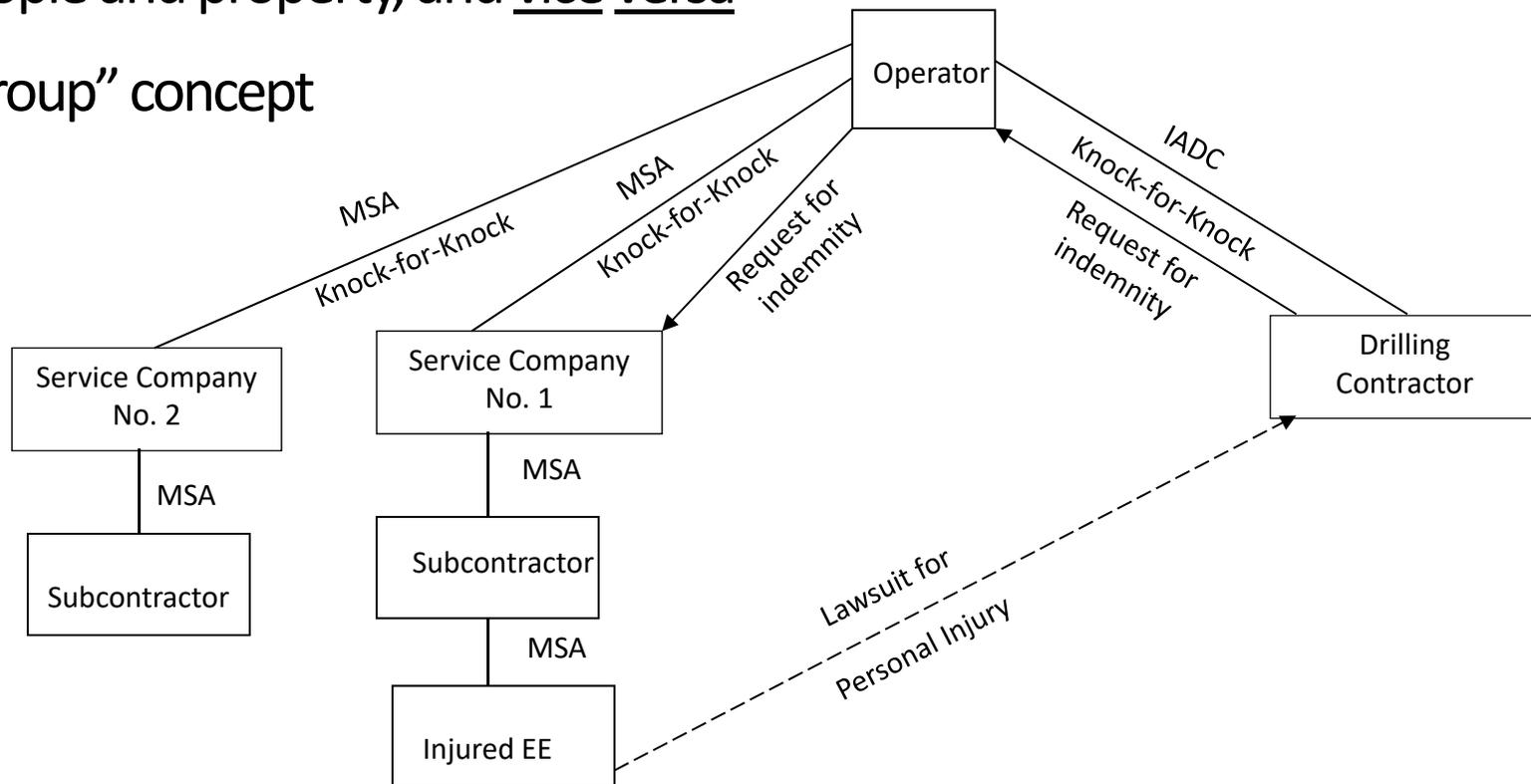
**Minimum Language Required to Satisfy
Conspicuousness and Express Negligence Rules:**

- Must specifically mention the negligence of the indemnified party.
- Make sure the indemnity provision is in a different font, is bold, or otherwise made to stand out from the rest of the language in the contract. For example:

“REGARDLESS OF FAULT” shall mean without regard to the cause or causes thereof including, without limitation, the sole, joint and/or concurrent, active or passive negligence or strict liability of any person or party, including the indemnified party or parties or the unseaworthiness of any vessel.”

“Knock-for-Knock” Indemnities

- Party A indemnifies Party B from claims of injury or damage to Party A’s people and property, and vice versa
- “Group” concept



- Enacted as Chapter 151 of the Texas Insurance Code

- Chapter 151 Texas Insurance Code applies to:
 - “Construction contracts” or agreements collateral to construction contracts
 - “Construction contract” means a contract, subcontract, or **agreement** for the **design, construction**, alteration, renovation, remodeling, repair, or **maintenance** of, or for the furnishing of material or equipment for, a building, structure, appurtenance, or other **improvement** to or on public or private real property, including moving, demolition, and excavation connected with the real property. . .
 - Public and private projects

➤ Does not apply to:

- Contracts pertaining to a single family house, townhouse, duplex, *or land development directly relating thereto*
- Public works of *municipalities*
- **Agreements subject to the TOAIA**
- Indemnity for copyright infringement claims
- General agreements of indemnity required by sureties
- Breach of contract or warranty existing independently of indemnity obligation
- Joint defense agreements entered after claim is made

In energy construction and maintenance, the Construction Anti-Indemnity Act applies to pretty much all projects unless the TOAIA applies

Provisions that require an **indemnitor** to *indemnify, hold harmless, or defend* a party *against claims caused by the negligence* or fault, violation of a statute, ordinance, governmental regulation, standard or rule, or breach of contract *of the indemnitee, its agent or employee or any third party under indemnitee's control or supervision* (other than indemnitor, its agents, employees or subs)

- No indemnification for the indemnitee's negligence or other fault
- Void and unenforceable **to the extent** they violate this statute



- Any party to a construction contract can require another party to indemnify it even for its own sole or partial negligence or other fault where the claim is one of bodily injury to or death of the employees of the indemnitor or its subcontractors
- Permissible for an upstream party to require a downstream party to indemnify the upstream for all bodily injury claims of the downstream party's employees or subcontractors regardless of fault
- The reverse is also true
- Means “knock” for “knock” indemnity for employee injury is enforceable under both statutes

- Property Damage (and other types of claims)
 - Is “knock” for “knock” enforceable?
 - No, but potentially may be enforceable to the extent it is not void (*i.e.* to the extent of the indemnitor’s negligence or other fault)

- Additional insured coverage cannot be used as a workaround for the construction anti-indemnity statute
 - Any contractual provisions or additional insured endorsements that provide coverage greater than allowed indemnity provisions are void
 - No additional insured coverage for additional insured's sole or concurrent negligence (unless statute is inapplicable to claim or employee bodily injury exception is at play)
 - Void *to the extent* they exceed the indemnity prohibitions
- Distinct from TOAIA

- Take advantage of employee bodily injury exception and get defense and indemnity even for indemnitee's negligence
 - Must still meet fair notice requirements
- Have separate general indemnity and defense provision for all other claims subject to Chapter 151
 - Downstream party must defend and indemnify upstream party to the extent of downstream party's own negligence

INDEMNITY FOR CERTAIN BODILY INJURY OR DEATH CLAIMS. TO THE FULLEST EXTENT PERMITTED BY LAW, CONTRACTOR SHALL INDEMNIFY, DEFEND AND HOLD HARMLESS THE COMPANY GROUP FROM AND AGAINST ALL CLAIMS, LOSSES, EXPENSES, COSTS, DEMANDS, SUITS, CAUSES OF ACTION, AND DAMAGES, INCLUDING WITHOUT LIMITATION, ATTORNEYS' FEES AND EXPENSES, FOR BODILY INJURY OR DEATH OF ANY EMPLOYEE OF CONTRACTOR, ITS AGENTS, OR ITS SUBCONTRACTORS OF EVERY TIER, EVEN IF THE BODILY INJURY OR DEATH IS CAUSED BY OR ALLEGED TO HAVE BEEN CAUSED BY THE SOLE OR PARTIAL NEGLIGENCE, FAULT OR STRICT LIABILITY OF ANY INDEMNITEE.

INDEMNITY FOR ALL OTHER CLAIMS. FOR ALL CLAIMS NOT ADDRESSED IN SECTION [], INCLUDING, WITHOUT LIMITATION, CLAIMS FOR DAMAGE TO OR LOSS OF USE OF PROPERTY AND CLAIMS FOR BODILY INJURY TO OR DEATH OF ANY PERSON OTHER THAN THAT ADDRESSED IN SECTION [], TO THE FULLEST EXTENT PERMITTED BY LAW, CONTRACTOR SHALL INDEMNIFY, DEFEND AND HOLD HARMLESS COMPANY GROUP FROM AND AGAINST ALL CLAIMS, LOSSES, EXPENSES, COSTS, DEMANDS, SUITS, CAUSES OF ACTION, AND DAMAGES, INCLUDING WITHOUT LIMITATION, ATTORNEYS' FEES AND EXPENSES, OF ANY NATURE WHATSOEVER ARISING OUT OF OR RELATED TO THIS CONTRACT OR THE WORK TO BE PERFORMED UNDER THIS CONTRACT, BUT ONLY TO THE EXTENT OF THE NEGLIGENCE OR OTHER FAULT OF THE CONTRACTOR, ITS AGENTS, REPRESENTATIVES, EMPLOYEES OR SUBCONTRACTORS OF ANY TIER.

SUBCONTRACTOR AGREES TO INDEMNIFY, DEFEND AND HOLD HARMLESS BALFOUR . . . FROM AND AGAINST ALL CLAIMS. . . ARISING OUT OF, OR RESULTING FROM THE PERFORMANCE, OR FAILURE IN PERFORMANCE, OF SUBCONTRACTOR'S WORK ... WHICH (1) IS ATTRIBUTABLE TO BODILY INJURY, SICKNESS, DISEASE, DEATH, INJURY TO OR DESTRUCTION OF TANGIBLE PROPERTY ... AND (2) IS CAUSED IN WHOLE OR IN PART BY ANY ACTS, OMISSIONS OR NEGLIGENCE OF SUBCONTRACTOR OR ANYONE DIRECTLY OR INDIRECTLY EMPLOYED BY SUBCONTRACTOR OR ANYONE FOR WHOSE ACTS SUBCONTRACTOR MAY BE LIABLE REGARDLESS OF WHETHER IT IS CAUSED IN PART BY THE ACTS, OMISSIONS OR NEGLIGENCE OF A PARTY INDEMNIFIED HEREUNDER.

United States Travelers Cas. & Sur. Co. Travelers Cas. & Sur. Co. v. Int'l Fid. Ins. Co., W-14-CV-427, 2015 WL 12734070, at *3 (W.D. Tex. June 25, 2015)

➤ Additional Insured Coverage

- Continue to request broadest forms available
- Only void to the extent they exceed prohibited indemnity (i.e., for the additional insured's sole or concurrent negligence or other fault)
- All coverage should apply to ongoing and completed operations, should be primary and non-contributory and should apply to additional insured's sole negligence to the extent permitted by applicable law
- Savings language: to the extent permitted by applicable law

➤ CPRC 130-Indemnification in Certain Construction Contracts

- Contractor cannot be required to indemnify architect/engineers for architect/engineers' own negligence
- Architect/Engineer cannot be required to indemnify owner for owner's own negligence
- Not repealed or even mentioned in anti-indemnity act
- Presumably could invalidate an indemnity clause seeking to take advantage of the bodily injury exception under Tex. Ins. Code Ch. 151
 - No cases

- When you are using one contract but it might implicate TOAIA at times or the Construction Anti Indemnity Act at other times
 - Draft two indemnity schemes?
 - Also, consider:
 - Knock for knock – depend on partial reformation
 - Knock for knock on bodily injury only with fault based indemnity for other types of claims