

Contractual Breaches & Termination

Legal Issues to Consider When Your Customer Walks Away from the Contract

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Brent crude oil prices, January 2014 - January 2016

— \$ per barrel



Source: Bloomberg

BBC

Presentation Overview

- i. Contract Termination
- ii. Pretexts for Termination
- iii. Rights & Recovery
- iv. Questions

Contract Termination

Topic Overview

- Default Provisions
- Standard of Care
- Right to Cure
- Communications

What to Protect Against

- Repeated failures
- Lack of Response
- Unreasonable Response
- Other Soft Spots

Default Provisions

- “if CONTRACTOR does not meet the standard of performance with respect to the Services due to unreasonable slow progress. . .according to **Good Oil and Gas Field Practices**.”
- “if CONTRACTOR **repeatedly fails** to conduct the Services in accordance with Good Oil and Gas Field Practices.”
- “if CONTRACTOR commits a **material breach** of its obligations under this Contract.”

What is Material Breach?

- THE FAILURE TO DO SOMETHING THAT IS SO FUNDAMENTAL TO THE CONTRACT THAT THE FAILURE TO PERFORM THAT OBLIGATION DEFEATS THE BASIC PURPOSE OF THE CONTRACT OR MAKES IT IMPOSSIBLE FOR THE OTHER PARTY TO PERFORM UNDER THE CONTRACT.

Right to Cure

- “With respect to each of the items of default identified in [the Termination Section], the right of COMPANY or CONTRACTOR to terminate this Contract **shall be suspended** if the defaulting party:
 - provides notice in writing that it elects to remedy such default.

FAILURE TO CURE

- “If within thirty (30) days of receipt of the original Notice of default the defaulting Party has failed to cure such default or to commence to cure. . .to the **non-defaulting Party’s reasonable satisfaction**, the non-defaulting Party shall be entitled to terminate this Contract”

How Can You Define a Better Standard

- “If within thirty (30) days of receipt of the original Notice of default the defaulting Party has failed to cure such default or to commence to cure. . . **TO THE DEGREE EXPECTED FROM A REASONABLY PRUDENT CONTRACTOR**, the non-defaulting Party shall be entitled to terminate this Contract”

Pretexts for Termination

Gambling, here?



- **Identify material obligations in the contract and demand strict adherence**
- **Identify deficiencies in performance and demand improvement**
- **Exercise no discretion**
- **Focus on “gotcha” issues**
- **Prepare plausible rationale for denying cure**
- **Maintain leverage in negotiations**

A party trying to get out of a contract will be proactive and opportunistic in identifying rationales to terminate.

- Increased correspondence
- Critical approach in meetings
- Strict performance requirements
- Changes in counter-party personnel
- Focus on duties, rights, and deliverables
- Exercise of audit rights

- Opportunistic / Contingent
 - Incident
- Planned / Exploitative
 - Rig Maintenance & Condition
 - Training
 - Regulatory Compliance

The operator will try to make the incident seem as bad as possible. Critical themes include:

- Contractor responsibility
- Failure to notify or consult
- Repetition or linkage of incidents
- Serious deviation from standard of performance
- Ignorance of prior learning or alerts
- Regulatory implications

Don't treat an incident, however minor, as business as usual. Assume it can cause termination and be proactive in responding.

- Involve senior management and legal
- Participate in an investigation or investigate independently; don't cede investigation to the operator
- Hire consulting experts who can be weaponized for litigation
- Employ best practices in accord with contract and policies in responding, and respond immediately

Contracts require maintaining rigs in good condition. Beware numerous or safety-critical maintenance items providing a pretext to terminate.

- “RIG to be maintained by CONTRACTOR with original equipment manufacturer parts where available”
- “The rig is to be fit in every way to conduct drilling operations as contemplated in this Drilling Contract and to be kept in thoroughly efficient order. All drilling equipment, machinery, pumps, and navigational equipment will be maintained in fully functional working order and condition.”

Contractual requirements regarding contractor personnel are increasingly complex and provide avenues for the operator to allege breach.

- “Contractor assures Company that all personnel are trained in all aspects normally encountered in performing Work of the kind envisioned by this Contract . . . Contractor training requirements shall meet or exceed Company’s minimum requirements as described in this Contract and the Company’s Safety Management System.”
- “Contractor must obtain prior approval from Company Representative before deploying, changing, or substituting personnel assigned Company Work.”

The HSE Annex and Bridging Documents contain innumerable general and specific obligations that may serve in a pretextual claim.

- “Performance is stewarded and a system for assessing performance is used to provide feedback, correct deficiencies, and report monthly on the performance of services.”
- “Contractor Rig and Shore-Based Management demonstrate leadership and commitment with accountability at all organizational levels to encourage active and personal roles in complying with safety, environmental, and regulatory standards. Contractor Rig and Shore-Based Management will participate in quarterly rig assessment activities with Operator Personnel and produce an accountability report.”
- “Full compliance with Applicable Law: No issuance of non-compliance notices from governing authorities. No environmental incidents.”
- “Contractor will deliver to its employees copies of Contractor’s Policies, Company’s Policies, the HSE Bridging Document, the Well Control Bridging Agreement, and other relevant documents as may be applicable to the Work under this Contract, and Contractor warrants that all Contractor employees will be familiar with and adhere to the contents of these documents in performing the Work.”

Get ahead of the game in assessing contractual and performance weaknesses, implementing improvements, and preparing a strategy.

- Involve senior management and legal
- Read the contract, bridging agreement, and related documents closely
- Identify “gotcha” items and formulate responses – course of dealing; explicit approval; etc.
- Work with the operations teams to identify where there are deficiencies and prioritize addressing them
- Revise operational approach to account for potential dispute; consider taking offensive in dealing with operator on potentially troublesome issues

Terminating on a pretext works as a strategy largely because of one-sided and badly conceived contracts. Fight for better terms going forward.

- Clear and mainstream performance standards
- Formal and prolonged termination procedure
- HSE, training, maintenance, and other obligations keyed to reasonableness
- Generous remedy and cure provisions
- Limited audit and investigation rights
- Limited incorporation of other documents

Recovery Rights & Remedies

- Damages Availability
- Statutory Liens and Privileges
- Consequential Damages Clauses

- Convenience Termination Provisions – Recovery Specified in Contract
- Standby Rate – Reduced Rate
- Mitigation of Damages

- **Actual Damages** - *MTO Mar. Transp. Overseas, Inc. v. McLendon Forwarding Co.*, 837 F.2d 215, 216 (5th Cir. 1988)
- **Liquidated damages**, unless the liquidated damages clause is determined to be a penalty as a matter of law.
 - \$5,000/hr liquidated damages charge held to be reasonable and not a penalty. *Farmers Exp. Co. v. M/V Georgis Prois*, 799 F.2d 159, 165 (5th Cir. 1986)
 - Fifth Cir. refused to enforce \$30k/day liquidated damages. *Louis Dreyfus Corp. v. 27,946 Long Tons of Corn*, 830 F.2d 1321, 1332 (5th Cir. 1987).
- **Prejudgment interest.** *Reeled Tubing, Inc. v. M/V Chad G*, 794 F.2d 1026, 1028 (5th Cir. 1986) (“Under maritime law, the awarding of prejudgment interest is the rule rather than the exception, and, in practice, is well-nigh automatic.”)

- Efforts to Market Rig
- Operational Overhead
- Track Expenses

- Powerful Instrument
- Evaluate Exposure
- Waiver / Exclusive Remedy Provisions
- Compliance with lien statutes
 - Louisiana / Texas

What are they?

- n. (16c) A legal right or interest that a creditor has in another's property, lasting usu. until a debt or duty that it secures is satisfied. Typically, the creditor does not take possession of the property on which the lien has been obtained. LIEN, Black's Law Dictionary (10th ed. 2014)
- Both Texas and Louisiana have statutes that grant liens for services and goods provided in the oilfield.

General concepts

- Strict compliance with the lien statutes required for enforceability.
- The lien must be filed with the county or parish clerk in which the property is located within a certain timeframe, as set forth in the statute.
- The lien must be filed within a certain time period, with notice provided to owners and interest holders.
- The lien must be enforced within a certain timeframe, as set forth in the statute.
- Necessary information for statutory compliance may be located in contract documents, overdue invoices, operating rights assignments, and online resources, to name a few.
- Attorney fees may be recoverable

Texas Property Code Chapter 56

- To secure lien, claimant must file an affidavit not later than six months after the day the indebtedness accrues with the county clerk of the county in which the property is located. Tex. Prop. Code § 56.021(a).
- At least 10 days before the affidavit is filed, a “mineral subcontractor” must serve written notice on the property owner. Tex. Prop. Code § 56.021(b).
- The claimant must enforce the lien within two years after the last day a claimant may file the lien affidavit or within one year after the completion, termination, or abandonment of the work under the original contract, whichever is later. Tex. Prop. Code § 56.041 and § 53.158.
- Note that if a subcontractor files a lien, the property owner can withhold payment to the contractor pending the outcome of that payment dispute. Tex. Prop. Code § 56.043.

Louisiana Oil Well Lien Act LSA-R.S. 9:4861, *et seq.*

- The “privilege” in Louisiana must be filed within 180 days of the last activity or event on a well site giving rise to the lien in order to be effective against third parties. LSA-R.S. 9:4865(A).
- A 90 day lapse between events requires separate lien filings for each event. LSA-R.S. 9:4864(C).
- Notice must be provided to the operator within the same timeframe. LSA-R.S. 9:4867(A).
- The amount of reasonable attorney fees cannot exceed 10% of the amount claimed. LSA-R.S. 9:4862(B)(4).
- Can attach to hydrocarbons. LSA-R.S. 9:4869.
- Enforcement must be brought within one year of filing. LSA-R.S. 9:4865(B).

Offshore

- For operations within the territorial waters of a state, the laws of that state control.
 - For Louisiana, “privilege” should be filed in the parish directly north of the wellsite.
 - For Texas, lien should be filed in the county adjacent to the offshore wellsite.
 - Liens may be filed in multiple counties and/or parishes to ensure effective liens.
- For operations on the outer continental shelf, state lien laws act as federal surrogate law under the Outer Continental Shelf Lands Act, 43 U.S.C. § 1331, *et seq.*
 - The same rules for territorial water operations apply.
- Multiple options, where to file?
 - Consider statutory requirements, timing, and allowable relief.
 - Consider what the contract says, if anything.

- Purpose: to allocate first party risks between counterparties
- Scope: defined or undefined
- Language implications

“Consequential Damages” means the following:

- (1) special, punitive, indirect, or consequential losses or damages or
- (2) ... economic loss, profits, expected or anticipated profits, or revenue, financing or capital or access to same, or loss thereof, ... and other additional costs indirectly resulting from breach of this Contract ... liquidated damages or penalties resulting from the failure to meet other contractual commitments or deadlines . . .

OPERATOR GROUP SHALL NOT BE RESPONSIBLE FOR OR LIABLE TO CONTRACTOR GROUP FOR ANY CONSEQUENTIAL DAMAGES OF CONTRACTOR OR THE OTHER MEMBERS OF THE CONTRACTOR GROUP. CONTRACTOR SHALL AT ALL TIMES BE RESPONSIBLE FOR AND INDEMNIFY THE OPERATOR GROUP FROM AND AGAINST ALL INDEMNIFIABLE CLAIMS OR LOSSES FOR OR ON ACCOUNT OF CONSEQUENTIAL LOSSES OF THE CONTRACTOR GROUP.

EXCEPT AND SUBJECT TO THE EXPRESS ASSUMPTIONS OF RESPONSIBILITY AND INDEMNITY OBLIGATIONS IN THIS CONTRACT, OPERATOR GROUP SHALL NOT BE RESPONSIBLE FOR OR LIABLE TO CONTRACTOR GROUP FOR ANY CONSEQUENTIAL DAMAGES OF CONTRACTOR OR THE OTHER MEMBERS OF THE CONTRACTOR GROUP. CONTRACTOR SHALL AT ALL TIMES BE RESPONSIBLE FOR AND INDEMNIFY THE OPERATOR GROUP FROM AND AGAINST ALL INDEMNIFIABLE CLAIMS OR LOSSES FOR OR ON ACCOUNT OF CONSEQUENTIAL LOSSES OF THE CONTRACTOR GROUP.

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Questions

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