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4. Ruminations on Contract Drafting

Best Practices in Drafting Offshore and Onshore Form Agreements

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I. Introduction

A. Purpose

The purpose of this paper is to address a number of recommended practices for preparation of agreements typically utilized in the energy industry. Specifically, this paper is meant to assist attorneys in preparing and drafting a “forms library” of agreements for a client in the oil and gas business. For example, imagine that a new client seeking to enter into the oil and gas business asks the attorney to prepare all of the “standard” documents that will be necessary in these transactions. How and where does one begin?

B. Where to Begin

Every agreement, regardless of type, has a standard structure that should be utilized. The efficient practitioner should prepare a “bare bones” agreement that has this standard structure. Anytime the attorney must prepare a contract “from scratch,” this standard agreement may then be broadened, elaborated upon, and adapted so that it is appropriate for the client’s particular needs. Although many model forms exist within the oil and gas industry, the role of the form nevertheless occupies a paramount position in the drafting process. This is especially true when an industry standard model form is not available. After suggesting general principles to use when drafting any type of agreement, this paper will then discuss considerations specific to agreements used in the energy industry.

II. Forms and Templates

A. Electronic Document Aids

One means to improve drafting skills is to create a template from which to work. A template is a means to create a standard document and may either contain complete provisions or be limited to layout and to styles. The latter can include the most basic formatting of your documents as well as the more elaborate headers and footers. Setting your choices in one template will allow you to be consistent in the style of your documents and enable you to prepare contracts and agreements more efficiently. Some of you create and modify your own templates and some of you will use assistants to perform this task. Even when you do not actually create the template yourself, it is a useful tool and it is helpful to understand how these work to determine if you wish to use...
them or not.

1. Electronic Internal References

Internal references are useful for many reasons, one of them is to easily update your draft, but also to enable the reader to go directly to the section or article of the paper referred to in a table of contents or a cross reference. Each of the following internal reference methods can be created with word processing programs and will be used for different types of drafting. All are found in the index and tables “insert” selection of Microsoft Word. Other programs will have similar tools. The drafter may use the preexisting formats or customize to suit particular needs. For oil and gas trade documents, the first two listed will be used more frequently, while for court documents and scholarly papers, the latter two are important tools.

a. Table of Contents. The Table of Contents is created at the time the document is drafted. Each time there is a new article, section or sub-section created in the documents, the words are marked by levels to create the Table of Contents. The convenience of being able to update this as you revise your drafts cannot be overestimated. If you are creating a lengthy purchase and sale agreement parties reviewing the documents will be able to link to specific articles or sections of the document.

b. Cross References. If you are creating a document with attachments and exhibits, the cross reference function allows the drafter to tie together the internal document references with links that expedite the ability of the reviewer or reader to find the relevant place in the document. It allows you to mark the document by numbered item (i.e. an outline) headings, footnotes, endnotes, etc. and then by page or paragraph number. This is a flexible tool for the drafter.

c. Table of Authorities. All references to authority in a paper or court filing may be automatically inserted when drafting by the use of this tool. It creates the table from data entered and marked electronically.

d. Footnotes. Footnotes may be used in documents that are not scholarly papers and this can be a great time saver. The automatic function allows renumbering when footnotes are added or deleted. You may create end notes using the same function or transform footnotes to end notes and vice versa.

2. Headers and Footers

Preset headers and footers in documents allow the drafter to automatically set page numbers, document name or number, the date and time of the completion of a draft, the author of the document or any other information desired. Some of the information may be inserted so that it is
automatically updated as new drafts are created and can be invaluable in keeping straight different versions of a document.

3. Comparing Documents

Many attorneys drafting documents may use a proprietary program to compare versions of documents. These are not always available to clients. The revision function of a word processing program (e.g., Track Changes in Microsoft Word) can accomplish the same task. It allows both the drafter and the reviewer to quickly find and compare all revisions to a document. It allows the client and others to see who made the changes and it allows comments to be inserted by the parties reviewing or drafting the document.

4. Execution and Acknowledgment

Although these are not difficult conceptually, signature and acknowledgment blocks require careful drafting to comply with statutory requirements. You must ensure that when documents are going to be recorded they meet the requirements of the jurisdiction in which they will be filed, or risk the documents being returned by the recorder’s office. The drafter can save time by having the form of acknowledgment ready to complete and by requesting the opposing party to provide their information before execution. Many of your clients may work with different entities, whether for operating purposes, tax purposes or other reasons. At each turn the drafter should ensure that the correct entity is actually executing the document. You will need to know the state of incorporation or registration for each entity on whose behalf the agreement is executed.

B. Drafting Tips

1. General Principles

In the subsequent sections, emphasis is placed on what is included in an agreement, how the agreement is organized, and the process of creating an agreement that is based upon the terms of the trade or the deal terms. Concurrently with the appropriate emphasis being placed on the substantive terms of an agreement, another important aspect is how the agreement is written. “We lawyers do not write plain English. We use eight words to say what could be said in two. We use arcane phrases to express commonplace ideas. Seeking to be precise, we become redundant. Seeking to be cautious, we become verbose. Our sentences twist on, phrase within clause within clause, glazing the eyes and

J. Lanier Yeates, Best Practice in Contract Drafting, 2006 Int’l Quality & Productivity Center: Advanced Contract Risk Management in Upstream Oil and Gas-Americas 6. Many thanks to Mr. Yeates for his encouragement and assistance to the authors in preparing this paper.
numbing the minds of our readers.” With the goal of clarity and brevity in mind, the following are suggestions to help one draft more clearly.

2. “Shall” and Words of Authority

Legal drafters often misuse the word “shall.” Properly used, “shall” creates a duty that attaches to a particular individual. Some commentators advocate eliminating the word altogether because of its prevalent misuse. However, if properly used, “shall” is more concise. For example, “must” does not create a duty; it only asserts that a duty exists. On the other hand, using “shall” in an agreement conveys that a duty arises from that provision. When drafting, if a word of authority is necessary but a duty is not being created, consider using the following in place of “shall”:

a. “must” — is required to
b. “must not” — is required not to; is disallowed
c. “may” — has discretion to; is permitted to
d. “may not” — is not permitted to; is disallowed from
e. “is entitled to” — has a right to
f. “should” — ought to
g. “will” — [one of the following]
   i. (to express a future contingency)
   ii. (in an adhesion contract, to express the strong party’s obligations)
   iii. (in a delicate contract between equals, to express both parties’ obligations)

3. Consistency

It is extremely important to be consistent when drafting agreements. Choose a style and numbering format and use it throughout the agreement. Once a particular phrase or punctuation style is used, strictly apply it throughout the agreement. If the agreement is later scrutinized during litigation, a court may determine that the use of different phrases to describe the same thing was done intentionally, which may result in an unintended and negative outcome for the client. If multiple agreements exist for one transaction, it is also important to remain consistent throughout all of the related agreements.

4. Other Specific Suggestions

3 Id. at 67.
Many of the words and expressions drafters utilize may not contribute to the goal of writing with clarity. Several are identified for your consideration: 4

a. “as such” — A connector that may be useful in persuasive and argumentative writing but, as a connector, should be avoided in drafting agreements.

b. pronouns — Pronouns should not be utilized in an agreement in instances where a proper name, defined term or other antecedent may be substituted. Although intended antecedents may be clear to the drafter, if disputes over interpretation lead to litigation, others may urge an alternative interpretation. This suggestion is based on avoiding ambiguity, enhancing clarity, and eliminating the pitfalls of a confused antecedent or ambiguous reference.

c. “aforesaid,” “hereinafter,” “hereby,” “hereof,” and “herein” — Assuming that these words in context have meaning, because of the inherent problem with confusion over the intended reference, these words should be avoided. Utilization of the word “aforesaid” may be intended by the drafter to refer to a prior provision or section in the same document. The better approach is to make specific reference to the provision or section that is the intended reference or antecedent. Utilization of the word “hereinafter” presents the same problems as utilization of the word “aforesaid.” Utilization of the word “hereby,” which may be intended to mean “by means of this agreement” or may signify an immediacy of taking effect as a result of the subject agreement, often is unnecessary and may be confusing. Again, with “hereby,” a question of reference is interjected into the document, that is, whether the intended reference is the entire agreement or a particular provision. The meaning of the drafter is more clearly expressed by utilizing “the parties intend” rather than “the parties hereby intend.”

d. “forthwith” — Contrary to popular notions of the meaning of “forthwith” as “simultaneously” or “instantaneously,” case law suggests that the meaning is “diligently,” “without unreasonable delay,” “with all reasonable dispatch,” or, interestingly, “with all reasonable dispatch consistent with the circumstances.” Although there may be times when the drafter would prefer to employ the term and gain flexibility based upon its interpretation by the courts, in other instances, the drafter may desire to be specific and avoid utilizing a term that is indefinite and has been the subject of interpretation by the courts that may not be consistent with the objectives of the drafter.

4 Yeates, supra note 1, at 7.
e. "said" — If for no other reason than for similarity to spoken English, the drafter may desire to substitute the word “such” for the word “said.” However, for clarity of reference, utilization of the word “said” should be avoided. Utilization of “said” by the drafter may or may not be intended to limit reference to a specific term, as it was utilized in an agreement, or limit reference to a specific document that was previously described in the document.

f. “any,” “all,” and “every” — Reported decisions indicate, contrary to what may seem reasonable, that, in a number of contexts, “any” generally means “all” or “every.” Authority exists in at least one decision that the word “any” may be utilized to indicate “all” or “every” as well as “some” or even “one.” The drafter should carefully consider the context when utilizing the word “any.”

g. “and/or” — Judges and legal writing commentators alike are very hostile of the phrase “and/or.” Although it means “one or the other or both,” to prevent ambiguity, avoid using it.

h. “in order to” — Generally, the drafter should refrain from utilizing the words “in order to” and, instead, utilize the word “to.” Sentence construction utilizing “in order to” or “to” may produce a non sequitur — grammatically, a dangling modifier. Although it may be tempting when describing legal requirements to begin a sentence with the words “in order to” or “to,” the drafter should check for continuity and consider alternatives rather than lead to a non sequitur. Sometimes, the drafter can write with clarity and avoid utilizing an “in order to” or “to” in the construction of a sentence. Generally, the drafter can recast a sentence to avoid the pitfall of a dangling modifier.

C. Form of the Agreement⁵

1. Title
   The title of the agreement should be centered at the top of the first page and typed in all caps. The title should clearly reflect what type of agreement it is. For example, use “Master Service Agreement” rather than “Agreement.”

2. Preamble or Introductory Clause
   The preamble or introductory clause follows the title. In general, it states the type of agreement, the date of the agreement, and the parties’ names.

   a. Type of Agreement. When referencing the type of agreement, use the same wording that is used in the title.

b. Date of Agreement. Use the more modern format March 26, 2008, rather than this 26th day of March, 2008. Unless stated otherwise in the agreement, the date listed in the preamble is the date the agreement becomes effective. To prevent confusion, do not include a date anywhere else in the agreement, including the signature block. However, if the parties are unlikely to sign the agreement on the same day, one may want to omit the date from the preamble, have the parties date their signatures, and include a provision stating that the agreement only becomes effective once the last party signs. Additionally, if the parties intend for the agreement to become effective after signing, do not include the effective date in the preamble. Use the date of signing instead and specify in the body of the agreement that it does not become effective until a specified later date.

c. Parties' Names. Identify individuals by their full name and entities by their registered name as stated in the official entity records of the jurisdiction of organization. After the name of the entity, state its jurisdiction of organization and the entity type. For example, Oil and Gas Exploration, LLC, a Louisiana limited liability company.

d. Extraneous Information. The following extraneous information should not be included within the preamble:

i. Parties' addresses — This should be included within the notice provision.

ii. Statement that a party is represented by a duly authorized representative — This should be addressed in a representation.

iii. Statement that a party is duly organized and validly existing — This should be addressed in a representation.

iv. Statement that the agreement is the binding agreement of the parties — This should be addressed in a representation.

v. Statement that the parties intend to be legally bound—This may be omitted because it is not a requirement for an enforceable contract.

3. Recitals

Recitals state the relevant background information of the parties and serve as a lead-in to the body of the agreement. Court use recitals to help determine the parties' intent but regard them as subordinate to the body of the agreement, so do not address the parties' rights, obligations, and representations in the recitals. Some courts have held that recitals are conclusive evidence of the facts they state. Do not include any facts in the recitals that the client is not sure are correct.6 Also, do not state

6 THOMAS R HAGGARD, LEGAL DRAFTING IN A NUTSHELL 44 (2d ed., West 2002).
anywhere in the agreement that the recitals are “incorporated by reference.” Finally, there is no need to use a heading such as “RECITALS” or “BACKGROUND.”

a. Types of Recitals. There are four kinds of recitals:

i. Context Recitals. These describe the conditions leading up to the transaction. The parties’ business operations may be included.

ii. Purpose Recitals. This is a brief description of the purpose of the intended transaction.

iii. Simultaneous-Transaction Recitals. If applicable, the agreement may also include recitals addressing agreements being entered into simultaneously with the current agreement.

iv. The Lead-In. The “lead-in” is the last recital in the agreement. It does not contain any background information and simply states that the parties agree to what follows.

b. Use of “Legalese”. Advocates of the “plain English” movement argue that drafters should not use legalese such as “WITNESSETH,” “WHEREAS,” and “NOW, THEREFORE” because each of these is archaic and unnecessary. The drafting attorney should determine whether to use these terms based on personal preference. One may also want to consider using complete sentences in the recitals rather than clauses ending in semicolons.

c. The “Lead-In” or Consideration Clause. Again, advocates of “plain English” contend that the last recital should simply state “The parties therefore agree as follows:” rather than using “NOW, THEREFORE, in consideration of the premises and mutual covenants set forth herein and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto covenant and agree as follows.” Regardless of the drafting attorney’s personal preference, an expression of consideration should not be omitted entirely. Since courts give some weight to recitals when determining whether a promise is supported by consideration, draft recitals in a way that contains information showing the parties’ promises are supported by consideration.

4. Definitions

Include a definitions section at the beginning of the agreement directly following the Recitals. Definitions should be in alphabetical order for easy reference.

5. Body

The main body of the agreement contains the main terms or substantive provisions of the parties’ transaction. This part of the
agreement should be well organized and contain headings, sections, and subsections. Provisions typically included within the body of the agreement are the business terms, representations and warranties, rights and obligations, insurance requirements, indemnities, actions constituting default, and remedies. These terms are very much transaction specific and highly negotiated between the parties.

5. Miscellaneous

In general, these provisions address administration of the agreement and some of them may be known as "boilerplate." Given that many of these miscellaneous and boilerplate provisions are included within most agreements, it is suggested that the drafter compile a database that includes numerous examples for each provision. When drafting an agreement, the attorney may then look to the database to locate the appropriate miscellaneous provisions that may easily be inserted into the agreement. However, before automatically inserting a particular provision, always consider whether the provision needs to be revised to better reflect the particular transaction. Do not include any boilerplate provision unless it is appropriate and worded properly for the transaction. The following is a list of common miscellaneous and boilerplate provisions (in no particular order):

a. Notice. This provision describes who the notice must be sent to, where, and by what means. Be sure to indicate when a party is deemed to receive notice.

b. Arbitration. If the client desires an arbitration clause, state information such as where the arbitration will take place, how many arbitrators there will be, and how the arbitrators will be selected.

c. Entire Agreement/Merger Clause. This provision makes clear that the agreement is the final and complete agreement of the parties.

d. Execution/Counterpart. If all parties are not signing the agreement at the same time, this provision makes clear that all counterparts taken together have the same effect as if all of the parties had signed the same document. A statement that facsimile signatures are equivalent to original signatures may also be included.

e. Further Cooperation/Further Assurances. This provision may be included to require the parties to take certain actions necessary to carry out the intent of the agreement after the agreement is signed.

f. Governing Law. This provision identifies which state or national law the parties want the court to use in construing and enforcing the

See generally, Id. at 45-50 (discussing the development of the term “boilerplate” and various boilerplate provisions).
agreement. Absent this provision, conflicts law determines the governing law.

g. Choice of Venue. This provision states the jurisdiction in which the parties must bring a claim.

h. Limitation of Damages. This provision makes clear that if a party defaults, the party's damages are limited to actual damages and incidental, consequential, special, indirect, multiple, statutory, exemplary or punitive damages are not recoverable.

i. Severability. This provision states that if a court declares any part of the agreement void or unenforceable, the remainder of the agreement is unaffected.

j. Modification. This provision requires the parties' written consent to modify or amend the agreement.

k. No Waiver. This provision makes clear that the failure of a party to require strict performance in one instance does not waive that party's right to insist on strict performance in the future. However, regardless of this provision's inclusion, some courts have found that the parties implicitly modified the contract through course of performance.

l. Assignment. This provision states whether the parties may assign the agreement to third parties, and if so, what is required to do so.

m. Successors and Assigns. This provision states that the agreement is binding upon and benefits the parties' respective successors in title and in interest, legal representatives, affiliates, subsidiaries, parents, successors and permitted assigns.

n. Force Majeure. This provision excuses delay or inability to perform an obligation under the agreement due to certain events out of each party's control, such as natural disasters, war, and governmental actions.

o. Survival. This provision states what terms, if any, survive expiration or termination of the agreement.

p. Third Party Beneficiaries. This provision makes clear whether any person or entity, other than the parties to the agreement, have any rights or remedies under the agreement.

6. Concluding Clause and Signature Blocks

The signature blocks are usually introduced by the concluding clause, which provides a smooth transition between the body of the agreement and the signatures. If the date of the agreement is stated in the introductory clause, use: "The parties are signing this agreement on the date stated in the introductory clause." If each signature is to be dated, then use: "Each party is signing this agreement on the date stated opposite that party's signature." A signature block provides a place for
the parties to sign. If the party signing is an entity, make sure that there is place for the individual signing on the company’s behalf to state his or her name and title. “By:” should be listed next to the signature line to make clear that the person is not signing in his or her individual capacity. Make sure that a page break does not separate the signature blocks of the parties. If this occurs, place the signature blocks together on one page. The signature blocks may also be located together on a separate page if a signatory needs to sign in advance so that subsequent revisions do not render the signature page obsolete. Either way, there may be a large blank space at the end of the body of the contract. In that case, place the following in the blank space: “[SIGNATURE PAGE FOLLOWS].” Also, if there are multiple agreements for the parties to sign, and the signature blocks are intentionally placed on a separate page, include the name of the agreement in the concluding clause or in a notation at the bottom of the page to ensure that the signature pages are not confused.

7. Attachments

Many agreements have documents attached to the back. There are two types of attachments—exhibits and schedules.

a. Exhibits. An exhibit is a document that stands alone by itself; it is relevant to the agreement but not a part of it. It may be an existing document, such as consent resolutions previously adopted, or a document that is ancillary to the agreement and will be executed simultaneously with the agreement at the transaction closing. An example is a promissory note to be executed pursuant to a purchase and sale agreement.

b. Schedules. In contrast, a schedule is a part of the agreement. It may be a disclosure schedule containing details of ongoing litigation or lists of contracts. Or, it may consist of a large amount of information that needs to be listed, such as technical data or oil and gas leases subject to a purchase and sale agreement.

III. Specific Agreements

A. In General

An attorney is frequently sent a letter agreement in the form of a Letter of Intent, Memorandum of Intent or Terms of Agreement and asked to prepare the documents that will accomplish the intent of the parties to the agreement. Frequently the client will indicate a deadline by which the agreements must be reviewed or executed by the parties. There may be considerations such as the availability of a drilling rig or lease expirations requiring the documents be signed sooner rather than later. It is extremely helpful to have some form on which to draw for purposes of expediting the preparation of the documents. Below we discuss some issues which may affect some types of trade agreements. A few recent cases cited below illustrate the importance of keeping up to date with
what the courts are doing, more in the common law producing states, than may be necessary in Louisiana. You should be aware of the most recent case law which may affect the way you draft the provisions in your agreements. The drafting attorney will realize that some of the issues decided in these cases will apply to several types of agreements. Many different types of agreements are utilized within the oil and gas industry. Discussing every conceivable type of agreement is beyond the scope of this paper. However, several of the primary agreements that a client in the oil and gas business will need are discussed below.

B. Letter of Intent

This is generally the first agreement between the parties and will be used as a guide to prepare the remaining documents. There is generally an outline of the terms of the deal as agreed between the parties. A Letter of Intent is not always complete as to every detail of the proposed deal and the parties rely on the final documents to set out the specific terms. One issue that may arise occurs when negotiations fall through and one party declines to go through with the deal. The other party may then bring suit for specific performance or damages. The Letter of Intent will then be examined to determine if the terms of the letter are binding on the parties. If the parties do not wish the Letter of Intent to be a binding contract, the document should expressly state this intent.

C. Exploration Agreements

Also sometimes called a Joint Venture, Exploration Agreements are one of the more flexible of the contracts used to govern the relationship of the parties in an oil and gas transaction. The parties' relationship or joint venture may be governed by the exploration agreement for the entire length of the venture or only for the drilling of an initial well. The agreement may specify that all subsequent activities will be governed by an operating agreement. The agreement generally provides for a contribution of land or leases by one party in exchange for a carried interest or overriding royalty in the initial operations under the agreement. Among other things, the terms may vary to provide for increasing the burden of the carried party after the initial well. The essential part of the drafting of this agreement, as in most others, is to understand the intent of your client and the other party to the agreement as to the rights and responsibilities of each. When your client asks you for a "simple" agreement, remind him of some of the possible outcomes when terms are not spelled out in sufficient detail and that a court interpreting a contract will have its own ideas of the intent of the parties. Contract law will be applied to interpret most industry agreements.

D. Farmout Agreements

1. In General

There are many issues to be considered when drafting a farmout agreement including what rights are to be earned by the farmee. Recent court decisions in Texas highlight the issues that may become the subject of dispute between the parties to these agreements. Careful drafting is essential to assist your clients in avoiding ambiguity or doubt in the interpretation of the terms of these agreements. Consult carefully with your client to avoid any possibility of the farmee and farmor disagreeing about the terms of the contract.

2. Wellbore

A recent decision handed down by the Texas Court of Appeals in Amarillo interpreted the definition of wellbore in an assignment granting clause. Although this dispute arose in connection with an assignment made as a result of an auction of oil and gas properties, many farmouts call for the farmee to earn wellbore assignments in which the farmor will retain interests outside of the wellbore. The language of the farmout agreement and the granting clause of the assignment should be clear to as to the intent of the parties.

3. Depth Earned

The Texas Court of Appeals in Corpus Christi interpreted the language in a farmout to determine what depths were earned by the drilling of a test well. The farmout provided that the “Assignment provided for above shall be limited in depth to 100 feet below the deepest producing interval as obtained in the test well . . . .” The court interpreted the language to limit the assigned interval to the actual depth of the producing zone in the well plus 100 feet. EOG argued that it should have earned rights to the producing sand regardless of measured depth. The court disagreed and EOG’s interest in a second well was reduced as a result. The language in the farmout and the subsequent assignment should have referred to a producing interval by reference to an existing well and stipulated that the depths earned would include this interval in the remainder of the farmout area if that was the intent of the parties. The court found the language to be unambiguous.

E. Drilling Contracts

1. In General

11 Id.
12 Id. at 345.
A drilling contract is an agreement for the drilling of a well or wells entered into between a drilling contractor, who owns drilling rigs and other equipment to drill wells, and a person or entity who owns or operates mineral rights or leasehold rights (called the "lessee" or "operator").

2. Types of Drilling Contracts

There are three types of drilling contracts: a daywork contract, a footage contract, and a turnkey contract. Each type is designed to allocate risk between the drilling contractor and the operator in a different way, although daywork contracts are the most widely used. As of October 2005, daywork contracts constituted 82% of all drilling contracts within the United States. This is largely due to the fact that daywork contracts are used whenever the demand for drilling is high compared to the availability of rigs.

a. Daywork Contract. This is a contract whereby the drilling contractor is paid a stipulated price for work performed per 24-hour day or portion thereof. In return for furnishing the drilling crew and drilling equipment, the drilling contractor is paid an agreed sum of money for each day spent drilling, regardless of the number of days involved. Historically, it has been viewed as more favorable to the drilling contractor since the contractor assumes less risk, and the operator assumes liability for the general risk of delay and the liabilities the contractor does not assume (the operator is willing to assume more risk because in the traditional daywork contract, the operator is in charge of day-to-day operations). However, modern forms have moved away from this and stipulate that the drilling contractor, acting as an independent contractor, is in charge of the day-to-day operations.

b. Footage Contract. This is a contract between an operator and an independent drilling contractor under which payment will be made on the basis of an agreed sum per foot of hole drilled, from the surface to the agreed maximum depth. In return for furnishing the drilling crew, drilling equipment, and certain specified services, materials, and supplies, the drilling contractor is paid an agreed sum of money for each
foot actually drilled, irrespective of whether the proposed depth is reached or not. In this type of contract, the drilling contractor assumes more of the general risks associated with drilling than the contractor does under a daywork contract. In general, the footage contract is viewed as more advantageous to the operator than the daywork contract because the contractor assumes more risk and the contractor is paid only for footage drilled.

c. **Turnkey Contract.** This is a contract in which an independent drilling contractor agrees to drill to a designated depth or formation for a fixed price. In return for furnishing the drilling crew, drilling equipment, and certain specified materials and services, to be due and payable only after the hole is drilled to contract depth, the drilling contractor is paid a fixed sum of money. Of the three types of drilling contracts, the contractor assumes the most risk under the turnkey contract because the operator has general control of all drilling operations. However, turnkey contracts are often drafted to address particular drilling conditions and place specified risks on the operator. Risks assumed by the operator include risk of loss due to the operator's negligence, risk of loss of the operator's equipment, risk of loss to the contractor's equipment at times when operations are conducted on a daywork basis, and the risk of damage to the oil and gas property.

3. **Specifying the Type of Contract**

It may be beneficial to the drafter to clearly specify the type of drilling contract, as it may become an issue during litigation. In *Brown v. WellTech, Inc.*, a drilling contractor agreed to deepen an existing well by 700 feet. The operator sued for damages after equipment was dropped down the hole during the course of drilling, and the well was lost. The contractor counterclaimed for payment of the contract price, at which point the type of drilling contract involved became an issue. The operator argued that it was a turnkey contract, and the contractor argued that it was a daywork contract because the stated consideration was for a specified rate per day. Upon remand, the court noted that a question of fact still existed as to whether the drilling contractor was entitled to compensation under the circumstances.

4. **Standard Provisions**

A detailed discussion of the standard provisions included within each type of drilling contract is beyond the scope of this paper. However, the following is a non-exhaustive list of standard provisions generally included within drilling contracts.

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18 Williams & Meyers, supra note 13, at 616; Anderson, supra note 15.
20 Anderson, supra note 15.
21 H. Harold Calkins, *The Drilling Contract—Legal and Practical Considerations*, 21
a. **Well Description.** Include the well name and legal description.

b. **Commencement Date.** Contractors should be aware of the risk associated with committing equipment to commence drilling a well by a certain date. If the contractor is already drilling a well for party A and commits to commence drilling by a certain date for party B, then should problems arise while drilling party A's well, the contractor may be unable to commence drilling for party B by the date specified in the contract. This risk may be alleviated by defining the "Commencement Date" as the point in time that the drilling unit either commences jacking operations or commences pulling anchors (whichever is applicable) preparatory to moving the drilling unit to the operator's first drilling location under the contract.

c. **Equipment Description.** A complete equipment description should stipulate which party is responsible for providing the equipment and what equipment is included in the prices set out in the contract.

d. **Applicable Rate of Compensation.** Specify the rate of compensation, including, if applicable, day work, footage rate, turnkey rate, standby time, force majeure, and the rate revision if the contract is not to be performed immediately.

e. **Stoppage of Work by Operator.** Typically, the contract includes a statement that the operator may order the work to stop or resume.

f. **Contract Term.** Be sure to stipulate the contract term, as this is particularly important in determining the end of the contract when a dispute arises between the parties.

g. **Responsibility for Property Loss/Damage.** Allocate the responsibility for loss or damage to the contractor's equipment, the operator's equipment, and to third party contractors' equipment.

h. **Liability for Environmental Damage.** Specify which party is liable for underground damage, blowouts, and pollution and contamination.

i. **Indemnification and Insurance.** Although indemnification and insurance requirements should be addressed as separate provisions within the drilling contract, they are discussed together because they are very much related to one another. The drafting attorney should be conscious of the interdependent nature of the indemnification, exculpatory, and insurance provisions. In general, the standard practice is for each party engaged in operations to remain responsible for its own employees and equipment and to indemnify the other party for any losses. The indemnification requirements should be supported by the appropriate amount of insurance, and the indemnitee is often named as an additional insured under the insurance policy. However, careful drafting is
extremely important. In *Helmerich & Payne International Drilling Co. v. Swift Energy Company*, drilling fluids spilled into a surrounding field while a contractor conducted well operations, which the operator then paid $155,000 to have cleaned up. The parties had entered into a drilling contract under which the contractor was required to maintain a Comprehensive General Liability ("CGL") insurance policy that included the operator as an additional insured. The operator made a claim for the costs incurred to clean up the spill, but the insurance company denied the claim, stating that the claim fell within the $750,000 deductible per occurrence for pollution claims. Rather than reimburse the operator, the contractor filed a declaratory-judgment suit to determine its obligations under the contract. The appeals court determined that under the drilling contract, the drilling contractor was not required to reimburse the operator even though the contract required the contractor to procure the CGL insurance and provided that all deductibles would be the sole obligation of the contractor. The court based its decision upon the fact that the indemnity provision within the contract stated that "notwithstanding anything to the contrary contained herein," the operator agreed to release, assume all responsibility for and indemnify contractor against all claims of every kind or character arising from pollution and contamination that arose during the conduct of operations.

**j. Confidentiality.** This stipulates that all information related to the well that is obtained by the contractor during operations (including information obtained as a result of negotiations or consultation regarding the contract) shall be held confidential by the contractor. Also, a confidentiality provision typically provides that the terms of the contract will not be disclosed publicly without consent. See infra text of Section IV. H. for further discussion of this provision.

**k. Relationship as Independent Contractor.** The modern approach in these contracts is to make clear that the drilling contractor is acting as an independent contractor.

**l. "Miscellaneous" Provisions.** For a discussion of various miscellaneous provisions included in contracts, see Section II of this paper.

**F. Master Service Agreements**

1. **In General**

Master service agreements are entered into between operators and contractors (including subcontractors) to allocate risk and stipulate each party’s responsibility in the oilfield. It is intended to govern all future

22 180 S.W.3d 635 (Tex. App.—Houston [14th Dist.] 2005, no pet.).

dealings between a particular operator and contractor so that the parties do not have to enter into a new agreement each time the operator issues a work order to the contractor.

2. Lack of Standard Form

Although sample master service agreements exist, such as the International Association of Drilling Contractors form and the master service agreement prepared by the Energy Law Committee of the Houston Chapter of the Association of Corporate Counsel, a standard form is impossible given the nature of the oil and gas industry. Master service agreements differ greatly depending upon the factual scenario and are highly negotiated, especially with regards to the indemnity and insurance provisions.

3. Indemnification and Insurance

The purpose of this paper is not to discuss indemnity and insurance provisions within master service agreements. However, the drafting attorney should be aware that in general, a master service agreement requires the contractor to indemnify the operator against any and all claims arising out of or in connection with the services and materials supplied by the contractor, regardless of whose negligence causes it. Typically, contractors are also required to carry minimum amounts of insurance coverage and to include the operator as an additional insured. (Note, however, that an anti-indemnity statute may apply. See supra Section V of this paper for a further discussion of anti-indemnity statutes.)

G. Joint Operating Agreements

1. In General

The American Association of Petroleum Landmen (A.A.P.L.) Form 610 – Model Form Operating Agreement ("JOA") is possibly the most used form of agreement by partners in oil and gas operations. The JOA is the industry standard governing operations of oil and gas properties by domestic on-shore companies. The forms are generally known by the year of adoption and the most prevalent are the 1982 and the 1989 forms. There are many operating agreements still in use that have been in effect since the 1940s and earlier. When preparing the JOA you should keep in mind that there may be landmen and attorneys in fifty years trying to

2008.


apply the terms of the JOA you prepared. The JOA generally contains the following information and provisions: describes the lands covered by the JOA; names the operator; sets out the duties and obligations of the operator and non-operator; it provides for removal of the operator; governs drilling of an initial well; governs operations of that well; governs the drilling of subsequent wells; and attempts to address the consequences to the parties of default by a partner; of bankruptcy; dry holes; loss of leases and many other activities that may take place between the parties during the term of the JOA. All of the previous provisions are fraught with the possibility of misinterpretation when a contract is not clearly drafted. One of the pitfalls of using any model form is that the drafter will fail to complete a section or will not change a particular provision to conform to the current agreement. It is essential to familiarize oneself with the provisions of the JOA and its exhibits in order to draft the document your client requires. At each step you should be certain you know your client's preferences and thoroughly understand the deal itself in order to meet those requirements. The most flexible part of the form itself will be Article XVI, or Other Provisions, where other terms of the JOA may be elaborated on or changed. It should include a conflict of terms section which will provide that the Article XVI provisions prevail over other provisions in the JOA. Recent case law in the jurisdiction where your client operates should be studied before drafting the JOA. The following will illustrate some of the current issues that should affect your discussions with a client as to the implications of the provisions selected.

There are also model forms for offshore and deepwater operations to which these comments will also apply and to which your attention is drawn.

2. Maintenance of Uniform Interest

Under JOA Article VIII, Acquisition, Maintenance or Transfer of Interest (the "MOI"), many operators will strike the preferential right to purchase section in order not to be restricted in selling or assigning an interest in a property, however the same operator may not consider the ramifications of Section D. Assignment: Maintenance of Uniform Interest. In ExxonMobil Corp. v. Valence Operating Co., 174 S.W. 3d 303 (Tex. App.—Houston [1st Dist.] 2005, pet. denied.), the court interpreted the MOI provision of an operating agreement to mean that ExxonMobil could not farm out a portion of a lease despite modifying the provision, in this case ExxonMobil had farmed out its interest in only one formation and Valence, one of ExxonMobil's partners, sued stating that the MOI had been violated by the farmout. The provision in the JOA read as follows:

26 ExxonMobil, 174 S.W.3d at 314.
Maintenance of Uniform Interest:

1. For the purpose of maintaining uniformity of ownership in the oil and gas leasehold interests covered by this agreement, and Notwithstanding any other provisions to the contrary, no party shall sell, encumber, transfer or make other disposition of its interest in the leases embraced within the Contract Area and in wells, equipment and production unless such disposition covers either:

   1. the entire interest of the party in all leases and equipment and production; or
   2. an equal undivided interest in all leases and equipment and production in the Contract Area.

Every such sale encumbrance, transfer or other disposition made by any party shall be made expressly subject to this agreement, and shall be made without prejudice to the rights of the other parties.²⁷

²⁷ Strikeouts in original.

The court said that "The intent of the parties in including the MOI provision in the JOA was to ensure that any party's conveyance of an interest under the lease conveyed either the party's entire interest or an equal undivided interest in all leases and equipment and production in the contract area. In short, the MOI provision evinces the intent of the parties not to partition the undivided interests in the leases."²⁸ This may not have been the original intent of the parties when the agreement was signed, but the court's interpretation of the provision meant that the effect was the same as if the provision had not been modified.

3. Preferential Right to Purchase²⁹

"A PRP has been defined as a right reserved by a party to a farmout or other agreement to buy the interest of the other party, provided it is willing to pay for such interest at a price which is offered therefor in good faith."³⁰ Should your client wish to have this provision in the JOA, you would be advised to review some recent case law. There may be many pitfalls in this provision.³¹

a. Notice. For a review of the consequences of inadequacy of notice under a preferential right to purchase see McMillan v. Dooley, 144

²⁷ Id. at 311.
²⁸ Id. at 314.
²⁹ See Arnold J. Johnson, The Preferential Right to Purchase in the Texas Oil Patch, presentation to the Houston Association of Lease and Title Analysts, July 18, 2000 (on file with author) for an excellent discussion of this topic.
³⁰ Id. at 1, citing See, e.g., Lulig Oil & Gas Co. v. Humble Oil & Ref. Co., 191 S.W.2d 716 (Tex. 1945); and H. Williams and C. Meyers, Manual of Oil and Gas Terms (10th ed. 1997).
³¹ Johnson, supra note 29, at 2.
S.W.3d 159 (Tex. App.—Eastland 2004, pet. denied). This decision related to three oil and gas leases and three lawsuits which were consolidated into one case. The Eastland Court of Appeals held that in one of the three cases a preferential right to purchase expired because it was not timely exercised. In this instance, the holder of the preferential right did not affirmatively assert the intent to exercise the preferential right, but instead made what the court interpreted to be a counter-offer to the preferential right letter. The court said the ten day period for exercising the right to purchase the property expired without acceptance by the plaintiff. If the preferential rights provision had been drafted to specify the terms to be disclosed to the other party, the plaintiff might not have lost his right. If the plaintiff had unconditionally stated his intent to exercise his preferential right to purchase, and also requested additional information concerning the terms of the proposed sale, then the court might have found in his favor and he could have kept the right alive. It is important that the language of the preferential right be drafted with clarity. If your client is preparing to exercise a preferential right to purchase, it is essential to follow the terms in the agreement.

b. Interests Subject to a Preferential Right to Purchase. A decision from the Texas Court of Appeals in Dallas found that an overriding royalty reserved in a farmout agreement was subject to the preferential right to purchase provision contained in the JOA executed at the same time, an outcome not necessarily foreseen by the parties to the farmout.

H. Confidentiality Agreements

A Confidentiality Agreement is drafted primarily to protect your client’s proprietary information from misuse by an outside party. Agreements may be created for different situations or transactions. Reasons for including a confidentiality agreement in your deal may be to protect information acquired while evaluating a prospect, another for a sale of assets, a third for a prospective partner.

1. Avoid Broad Language

The Agreement should be drafted to avoid broadness by specifying what exactly is to be held confidential. That is, a definition of what information is to be considered confidential should be included in the agreement.

33 Id. at 179–80. Plaintiff Dooley declined to accept additional properties listed in the preferential rights notice from defendants, and therefore was deemed by the court to have made a counter-offer. Id. at 176.
34 Id. at 180.
2. Who Should be Covered
The drafter should consider the persons allowed access to the information, and include consultants, legal advisors or employees of affiliates as appropriate.

3. Waiver of Public Information
The Agreement should specify its term and should also include waivers of information that is readily available to the public.

4. Include the Following
The Agreement should include the following provisions: a disclaimer, broad covenant not to sue, no obligation to accept the proposal to acquire properties, a duty to return or destroy all materials, and language addressing any legal request to disclose the information.

IV. Ensuring Consistency - Conforming Provisions within Multiple Agreements

A. Importance of Consistency
It is imperative that all agreements associated with one transaction are internally consistent. Inconsistency may result in unintended consequences and be very detrimental for the client if the client is later involved in litigation related to the transaction or the agreements governing the transaction.

B. Indemnity and Insurance Provisions
Again, although indemnity and insurance provisions should be separate provisions within each agreement, they are discussed together because they are very much interrelated. Not only should indemnity provisions be consistent with the parties’ insurance requirements in each agreement, they should also be consistent in all of the agreements associated with a transaction. The drafter does not want the indemnity and insurance provisions in the drilling contract to be negated or ignored because they are inconsistent with the indemnity and insurance provisions of the master service agreement. Another caveat you should observe is to note legal requirements for conspicuousness of the indemnity provision in the agreement. In order to make the provision conspicuous, the type for the indemnity language must be in bold. For most documents, we prefer to use the small caps option. See Subsection V.E.2 supra for a discussion of the Louisiana and Texas anti-indemnity acts which may govern your transaction.

C. Publicity
One client will want to protect its privacy, and indeed may want to keep others from learning that it is marketing certain properties or that it is going to be leasing in a certain area. Another client may have specific requirements for disclosing its activities or corporate policies governing the same if it is a publicly traded company. In certain instances, the
parties may wish to make an announcement of a joint venture. Any agreement or contract may contain a provision covering any of these. A provision prohibiting disclosure other than required by law is below:

**Publicity.** Except as required by applicable Law of any governmental body or stock exchange, neither Party shall issue any disclosure or press release with respect to the transactions contemplated by this Agreement.

D. Policies

The following provisions may be included in a different types of energy industry contracts, including a JOA. The decision as to which of these provisions to include in a contract will depend on the policies of the client. Some provisions will be included because they are regulatory requirements. The drafter should ensure that if a law or regulation is cited in the provision that it is the most current version.

1. *Contraband*

Statement of the company’s policies regarding possession of illegal drugs, or possession of firearms by employees, contractors or subcontractors on a job premises, particularly at a drill site, onshore or offshore. These may be driven by regulatory requirements.

2. *Non-Discrimination and Certification of Non-Segregation of Facilities*

Statement of compliance by the parties with various government regulations, such as the rules promulgated by the Department of Labor and the Department of Health, Education and Welfare.

3. *Safety*

A statement of the company’s policies regarding safety in the workplace and to comply with governmental regulations.

E. *Dispute Resolution*

The drafter must determine from the client how a dispute between the parties is to be settled. More parties now prefer to have an alternative to a lawsuit to settle differences. The parties may then wish to include dispute resolution language in an agreement. The parties may specify that any disputes are to be settled by arbitration and specify the Arbitration Rules of the American Arbitration Association be used in the process.

F. *Choice of Law*

The law chosen to govern interpretation of the contract is usually the law of the state in which the parties are located, however the parties may wish disputes over the terms of contract to be governed by the law of the state in which the property is located. A sample provision to be certain of your choice of law is:
**Governing Law.** THIS ASSIGNMENT SHALL BE GOVERNED BY AND INTERPRETED IN ACCORDANCE WITH THE LAWS OF THE STATE OF TEXAS, WITHOUT REGARD TO ANY CONFLICT OF LAW RULES THAT WOULD DIRECT APPLICATION OF THE LAWS OF ANOTHER JURISDICTION, EXCEPT TO THE EXTENT THAT IT IS MANDATORY THAT THE LAW OF SOME OTHER JURISDICTION, WHEREIN THE ASSETS ARE LOCATED, SHALL APPLY.

**G. Choice of Venue**

This choice will govern where a claim is tried. Sometimes venue is mandated. For instance, in Texas, a case involving a title dispute would be required to be tried in the county or parish where the property involved in the dispute is located. However, most clients will prefer that contract disputes be tried at the location of their corporate offices and this will be the venue of choice. A Houston company will wish venue for contract disputes to be Harris County, Texas.

**Venue.** ALL ACTIONS OR PROCEEDINGS WITH RESPECT TO, ARISING DIRECTLY OR INDIRECTLY IN CONNECTION WITH, OUT OF, RELATED TO, OR FROM THIS AGREEMENT OR ANY OTHER DOCUMENT REFERRED TO IN THIS AGREEMENT MAY BE LITIGATED, AT THE SOLE DISCRETION AND ELECTION OF ANY OF THE PARTIES, IN COURTS HAVING SITUS IN HOUSTON, HARRIS COUNTY, TEXAS. EACH PARTY HEREBY SUBMITS TO THE JURISDICTION OF ANY LOCAL, STATE, OR FEDERAL COURT LOCATED IN HOUSTON, HARRIS COUNTY, TEXAS, AND HEREBY WAIVES ANY RIGHTS IT MAY HAVE TO TRANSFER OR CHANGE THE JURISDICTION OR VENUE OF ANY LITIGATION BROUGHT AGAINST IT BY ANY PARTY IN ACCORDANCE WITH THIS SECTION.

Note that both the choice of law and venue provisions are "conspicuous."

**H. Confidentiality Provisions**

A confidentiality provision may be incorporated into an agreement incorporating many of the terms discussed in the Confidentiality Agreement above.

1. **Standard of Care**

The standard of care for a party holding information confidentially should be the same as the standard of care used to control its own information. The following is an example of the language that may be used to define the standard of care:
The standard of care applicable to all confidentiality provisions in this Agreement shall be that any Party who receives confidential information, data or proprietary rights of the other Party (collectively, the “Disclosing Party’s Confidential Information”) shall use at least the same degree of care to safeguard and to prevent the disclosure, publication, dissemination, destruction, loss or alteration of the Disclosing Party’s Confidential Information as it employs to avoid unauthorized disclosure, publication, dissemination, destruction, loss, or alteration of its own confidential information, data or proprietary rights (or information of its customers) of a similar nature, but in no case less than reasonable care.

2. Term

A precise term should be agreed to between the parties. The term of the confidentiality requirement should not be open ended.

V. Filling in the Details

A. In General

Drafting agreements when a client is an international entity or dealing with an international entity will require familiarity with some federal statutes. Doing business out of state may also require additional attention to regulations. Below are some issues to consider, particularly in acquisitions.

B. Qualifying to Conduct Business as a Foreign Entity

Each state will have its own requirements for two things that affect your client’s agreements. One requirement is to conduct business in the state and the second is to conduct oil and gas activities in the state.

1. Secretary of State

Qualifying to do business in a state requires filings with the Secretary of State and each state will have its own requirements.

2. State Regulation

Qualifying to operate oil and gas wells is governed by the laws of the state in which the wells are located and the lawyer should ensure the client is qualified in advance of a transaction in a state where the client has never operated.

C. Hart-Scott-Rodino

The Hart Scott Rodino Antitrust Improvements Act of 197636 (the “Act”) was adopted to provide the federal government with the opportunity to review the potential effects on competition of certain mergers, acquisitions or other consolidations that meet the Act’s criteria for size of a person or transaction tests. The parties to an agreement must file notifications with the Federal Trade Commission and the Antitrust Division of the Department of Justice. The agencies have a thirty (30)

day period to review or request further information from the parties. The parties may not close a transaction prior to the end of this period. Any transaction subject to the requirements of the Act should be reviewed by someone very familiar with the provisions of the Act.

D. Exon-Florio

The full title of the bill is the Exon-Florio Amendment to the Omnibus Trade and Competitiveness Act of 1988\textsuperscript{37} or the Foreign Investment and National Security Act of 2007 ("FINSA"). FINSA amended the Defense Production Act of 1950 review of foreign investments by the Committee on Foreign Investments in the United States ("CFIUS"). The law was intended to provide for an investigation or review of proposed foreign investments in the United States in order to restrict any direct foreign investment that threatens national security.\textsuperscript{38} The statute defines a covered transaction as "any merger, acquisition or takeover that is proposed or pending after August 23, 1988, by or with any foreign person which could result in foreign control of any person engaged in interstate commerce in the United States."\textsuperscript{39}

E. Area of Operations

1. Onshore or offshore

The drilling of onshore wells, unless on federal lands, is generally governed by the requirements of the state agencies having the charge to regulate the energy industry. As discussed above, the qualification of a company to operate oil and gas wells will be governed by the state agency in charge of the regulatory scheme. You should ensure that your client has complied with all requirements if this is a new venture for them.

2. State specific provisions

There are also differences that should be considered in drafting documents which are jurisdiction specific. If your client has operated in one state and decides to begin operating in another state, they should be made aware of those differences. Some statutory schemes in Louisiana and Texas that reflect some of these differences are discussed below.

a. Texas and Louisiana Oilfield Anti-Indemnity Acts: The Oilfield Anti-Indemnity Acts apply to provisions contained in any agreement pertaining to oil and gas wells. The two statutes are similar in their intent to prevent shifting the burden of defense or indemnification caused by negligence if there is negligence or fault


\textsuperscript{38} United States Department of the Treasury, Office of Foreign Affairs, Committee on Foreign Investment in the United States (CFIUS), http://www.treas.gov/offices/international-affairs/exon-florio/, last visited on February 27, 2008.

on the part of the indemnitee or its agents, employees or independent contractors causing the death or bodily injury to persons.\(^{40}\)

\[1. \text{Louisiana.} \] Under the Louisiana Oilfield Anti-Indemnity Act ("LOAIA"),\(^{41}\) contractual indemnity "provisions in oilfield contracts are void and unenforceable to the extent that they provide for indemnification for losses caused by the negligence or fault of the indemnitee."\(^{42}\) However, the Fifth Circuit found a narrow exception to the Act that permits indemnification for a party’s own negligence so long as the indemnitee procures and pays for the insurance coverage itself\(^{43}\). LOAIA does not affect the validity of any insurance contract, except as provided for in the Act. Certain contracts, such as farmout agreements and joint operating agreements are specifically excluded from the Act. Louisiana has no express insurance restriction in LOAIA. No insurance limitations are mentioned in the statute if an indemnification is allowed, however the source of payment for the insurance premiums was the deciding factor in the court disallowing an insurance policy in \textit{Amoco Production Co. v. Lexington Ins. Co.}\(^{44}\)

\[ii. \text{Texas.} \] The Texas Oilfield Anti-Indemnity Act was passed in 1973 ("TOAIA")\(^{45}\). One of the reasons for the prohibition of certain indemnity agreements is contained in Section 127.002 which states that it is against public policy to allow indemnification of a negligent indemnitee. Texas does allow indemnity agreements under the Act if the indemnities are mutual. Texas allows any amount of insurance for mutual indemnities as long as the amount is the same for both parties, but restricts the amount to the least insurance coverage. TOAIA expressly restricts the amount of unilateral coverage to $500,000.00.

\[b. \text{Texas and Louisiana Oil Field Lien Acts.} \] These are statutory schemes concerning the ability of contractors to file liens for work done on wells. Although these Acts may not affect how your


\(^{43}\) \textit{Marcel v. Placid Oil Co.}, 11 F.3d 563, 569 (5th Cir. 1994).

\(^{44}\) 745 So.2d 676, 680-81 (La. App. 1st Cir. 1999).

\(^{45}\) \textit{TEX. CIV. PRAC. & REM. CODE ANN.} § § 127.001–.007 (Vernon 2005).
agreement is drafted, you should be aware of how this type of lien (or privilege) may affect title to properties your client may be acquiring.46

i. Louisiana. The Louisiana Oil, Gas and Well Lien Act grants a privilege to persons who perform services or provide materials connected to operations.47

ii. Texas. The Texas Oil Well Lien Act grants to a mineral contractor or subcontractor a lien to secure payments for labor or services related to the mineral activities.48

F. Stock Exchange Requirements

If your client is a publicly traded company, and particularly if the company or parent is a non-domestic company, you should be aware of any legal requirements concerning filings or announcements. Publicly traded domestic companies must comply with Securities and Exchange Commission requirements. These companies should have financial advisors who will determine the disclosure requirements for sales, acquisitions, stock deals and other such agreements.

G. Tax Partnerships

1. Generally

In drafting trade agreements, you should determine whether the parties to a trade agreement wish to be considered as partners for income tax purposes. Familiarity with the implications of tax partnerships in the oil and gas industry is frequently limited to the trade documents attorneys may draft in which a client elects whether or not to create a tax partnership. In the 1989 AAPL Model Form Operating Agreement, for instance, this election is made under Article IX as a default exclusion from the application of Subchapter K of Ch. 1 of Subtitle “A” of the Internal Revenue Code. If the parties to the agreement decide to form a partnership, an additional Exhibit is included in the Operating Agreement. It will be the custom to advise the client who inquires that they will need to consult a tax specialist, unless of course, you are a tax specialist. However all drafters of transactional documents should be familiar with the reasoning behind such decisions.

2. Pool of Capital Concept

You should become aware of the “Pool of Capital Concept” in which parties each contribute goods or services to a deal. Older cases governed treatment of farmouts under the Pool of Capital concept. This concept originated in a case decided the Supreme Court in 1933, Palmer 46 See Patrick H. Martin and J. Lanier Yeates, Louisiana and Texas Oil & Gas Law: An Overview of the Differences, 52 LA. L. REV. 769 (1992).


48 TEX. PROP. CODE ANN. §§ 56.001–003 (Vernon 2007).
v. Bender, 287 U.S. 551 (1933), in which it was decided that no taxable income resulted from the contribution of goods or services toward the development of a mineral property in exchange for an interest in the property. The parties agreed to an exchange of acreage for the service of drilling the well. One party contributed leases and the other party labor, thus no taxable income resulted from the trade. This is the basic set up of a farmout agreement. When you are conversant with these concepts, you will know when to refer your clients to a tax specialist.

3. Revenue Ruling 77-176

Note that a taxable event may be created by a farmout agreement in which one party contributes land and another party contributes drilling expertise, for the farmor and for the farmee when the land earned under the farmout is more than the drill site. Being familiar with the consequences of Revenue Ruling 77-176 and Revenue Ruling 83-46 (which governs treatment of overriding royalties earned for services rendered) can assist you in understanding the issues which should be considered prior to a decision for create or not to create a tax partnership for income tax purposes.

4. Louisiana

In Louisiana, a written contract for the joint exploration, development, or operation of mineral rights does not create a partnership unless the contract expressly provides for creation of a partnership. Mineral Code art. 215.

VI. Final Thoughts

A. Updating Existing Provisions and Older Agreements

If using older agreements or existing provisions (such as those in a miscellaneous provisions database) as a starting point to prepare new documents, it is imperative to update these agreements and provisions so that they conform to existing law and standard industry practice. The provisions most likely susceptible to changes in the law are exculpatory, indemnity, and insurance provisions. Failure to keep abreast of current legislation and case law could result in unintended negative consequences for the client.

B. Conclusion

Preparing “form” agreements for clients within the oil and gas industry does not have to be complex, especially if the attorney has prepared a basic form that may be elaborated upon and specially adapted to the client’s particular needs. All well drafted agreements share

common elements. The key to preparing a forms library for a client within the oil and gas industry is to utilize these elements while simultaneously incorporating standard provisions contained in agreements typically used in the energy industry.