DRAFTER’S GUIDE TO INDEMNITY PROVISIONS IN TEXAS CONTRACTS
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- acquisitions, divestitures, construction and financing of pipelines, gathering systems and storage facilities for natural gas, crude oil, condensate, natural gas liquids and LNG
- acquisitions and divestitures of producing and non-producing oil and gas properties
- oil and gas joint ventures and exploration and development programs
- exploration and development project agreements including joint operating agreements, COPAS accounting procedures, exploration and development agreements and joint operating agreements
- natural gas purchase, sales and marketing agreements and NAESB agreements
- natural gas processing and treating agreements, oil and gas transportation agreements, natural gas storage agreements, natural gas supply agreements
- operating and maintenance agreements for mid-stream facilities
- production handling agreements
- master service agreements and IADC drilling contracts
- hedging, derivative, swap and ISDA agreements

Mr. King is listed in *Chambers USA* among the leading lawyers in the area of Oil & Gas Transactions. He has also been selected for inclusion in *Best Lawyers in America* in Oil & Gas Law, the *Houston Business Journal*’s "Who's Who in Energy" list, and recognized by ALM as a "2013 Top Rated Lawyer in Energy/Environmental."

Prior to becoming a lawyer, Mr. King spent 13 years practicing as an independent petroleum landman. His experience included negotiating oil and gas leases, title examination, structuring oil and gas property acquisitions and exploration transactions. Mr. King has been a Certified Professional Landman since 1984.

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Bass Wallace has been General Counsel of TETRA Technologies since 1994 and of its MLP subsidiary CSI Compressco LP since its initial public offering in 2011. He has also been a Senior Vice President at TETRA since 2011. Established in 1981 and based in the Woodlands, TETRA is a publically traded oil and gas services company operated through four segments - Fluids, Production Testing, Compression, and Offshore Services (which includes its remaining offshore oil and gas interests in its Maritech subsidiary). TETRA has employees and operations on six continents. Bass leads a four lawyer team that manages the entire legal function, as well as the Contracts Department and secretarial function. A native Houstonian, Bass also has served on the boards of several local non-profits.
Jonathan Castelan is a member of the Energy Transactions section of Porter Hedges. He represents international and domestic energy companies in a wide variety of transactions, including the following:

- Acquisitions and divestitures of oil and gas properties
- Midstream agreements
- Engineering, procurement, and construction (EPC) agreements
- International and domestic shipyard agreements
- International and domestic drilling contracts
- Asset purchase and sale agreements
- Oilfield services contracts
- Oil and gas leases
- Joint operating agreements

Mr. Castelan also has experience advising clients on a broad range of legal matters, including corporate strategy, corporate reorganization, and the U.S. Foreign Corrupt Practices Act (FCPA), in addition to other compliance policies and procedures.

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I. Introduction

II. Must-Know Concepts

III. Potential Unenforceability Issues

IV. Common Indemnity Schemes for:
   • Oilfield Service Contracts
   • Consulting Agreements for Engineers and other Professionals
   • Asset Purchase Agreements for Upstream Assets ("PSAs")
   • Midstream Agreements

V. Other Considerations for Indemnities
I. INTRODUCTION

Purpose of Presentation:

To inform in-house counsel of (i) must-know concepts, (ii) potential unenforceability issues, and (iii) common indemnity schemes in play in drafting oilpatch contracts.
II. MUST KNOW CONCEPTS

Must Know Concepts

- Knock-for-Knock
- Pass Through
- Holding the Bag
II. Must Know Concepts

“Knock-for-Knock”

- When both parties take liability for the injuries of their own people or property regardless of fault, we call that “knock-for-knock” or “mutual hold harmless.”

- People
  - Using the knock-for-knock concept for personal injury to one’s own employees is common.
  - Rationale on Personal Injury: One’s own employees are covered by workers compensation or employer liability insurance coverage.

- Property
  - Using the knock-for-knock concept for property damage to one’s own property is common.
  - Rationale on Property: One’s own property is covered by property damage insurance coverage.
II. MUST KNOW CONCEPTS

**People** Knock-For-Knock Indemnity

- Operator
- Service Company
- Injured EE

M SA

Knock-For-Knock

Request For Indemnity

Lawsuit for Personal Injury
**Property** Knock-For-Knock Indemnity

- Operator
- Service Company
- Damaged Service Company Property

**II. MUST KNOW CONCEPTS**
II. MUST KNOW CONCEPTS

“Pass Through”

- An indemnity “pass through” provision in an oilfield contract allows the indemnitee to pass the indemnity that it has received under the contract through to other persons as a matter of contract, e.g. its contractors, subcontractors, affiliates, etc.
- United front among defendants.
- Lower overall defense costs.
II. MUST KNOW CONCEPTS

“Pass Through”

Note: Contractor A will retain liability for its employee’s personal injury.
II. MUST KNOW CONCEPTS

“Holding the Bag” Concept

- As long as all indemnities in the Oilfield Service Contracts at any given wellsite contain knock-for-knock indemnities with pass through provisions, claims for personal injury and property damages will travel back to the employer of the injured employee or the owner of the property.

- When that does not happen perfectly under a broad form indemnity scheme, someone other than the employer or owner may become liable for the claim as a matter of contract.

- When an employee or owner becomes contractually liable for another party’s negligence because of imperfection in the pass through network, that is called being “left holding the bag.”
II. MUST KNOW CONCEPTS

“Holding The Bag” - People

Operator
(10%)

Drilling Contractor
(55%)

Service Contractor
(35%)

Injured EE

Request For Indemnity
For Lawsuit No. 1

Drilling Contract
Knock-for-Knock
w/ pass through

Request For Indemnity
For Lawsuit No. 2

Knock-for-Knock
w/o pass through

MSA

Lawsuit No. 1

Lawsuit No. 2

Lawsuit No. 3

Note: Since Operator’s MSA with Service Contractor does not have “Pass Through”, Operator is not able to be indemnified by Service Contractor for Lawsuit No. 1.
II. MUST KNOW CONCEPTS

“Holding The Bag” - People

Driller (85%)

Operator (15%)

Service Contractor (0%)

Injured EE

Note: Fault reallocated to Operator and Driller because Service Contractor can’t be sued due to Workers Comp.
II. MUST KNOW CONCEPTS

“Holding The Bag” - People

Operator (85%)  

Injured EE  

Service Contractor (15%)  

Note: Originally liability was as follows:  
Operator – 10% liable  
Service Contractor – 35%  
Driller – 85%
“Holding The Bag” - Property

Operator (10%)

Request For Release For Lawsuit No. 1 only
MSA Knock-for-Knock w/o pass through
Lawsuit No. 1

Service Contractor (35%)

Damaged Property

Request For Indemnity For Lawsuit No. 2
Drilling Contract w/ pass through
Lawsuit No. 2

Driller (55%)

Note: Since Operator’s MSA with Service Contractor does not have “Pass Through”, Operator is not able to request indemnity for Lawsuit No.2. Operator has to indemnify Driller for Lawsuit No. 2 and Operator is left “Holding the Bag”.

II. MUST KNOW CONCEPTS
II. MUST KNOW CONCEPTS

“Holding The Bag” - Property

Operator (55%)

Service Contractor (45%)

Damaged Property

Note: Originally liability was as follows:
Service Contractor – 35%
Operator – 10%
Driller – 55%
III. POTENTIAL UNENFORCEABILITY ISSUES

Four Ways Indemnity Contracts Don’t Mean What they Say

- Express Negligence Doctrine
- Conspicuousness Requirement
- Texas Oilfield Anti-Indemnity Act
- Texas Construction Anti-Indemnity Act
Express Negligence Rule and Conspicuousness Requirement

- One party (Party A) cannot be contractually required to indemnify another party (Party B) for Party B’s negligence unless:
  - The contract “expressly” states that Party A’s obligation as indemnitor applies even when the claim results from the indemnitee’s (Party B’s) own negligence, unseaworthiness and strict liability; and
  - The applicable indemnity is written in a “conspicuous” manner.
- The Texas Supreme Court in *Dresser Industries, Inc. v. Page Petroleum, Inc.* found that “the fair notice requirements of conspicuousness and the express negligence doctrine apply to both indemnity agreements and to releases.”
III. POTENTIAL UNENFORCEABILITY ISSUES

Express Negligence Rule and Conspicuousness Requirement

Ways to comply with Express Negligence Rule and Consciousness Requirement:

1. Define “Regardless of Fault” and use the term in each indemnity provision

“REGARDLESS OF FAULT” shall mean without regard to the cause or causes thereof including, without limitation, pre-existing conditions, whether such conditions be patent or latent, the unseaworthiness of any vessel or vessels, imperfection of material, defect or failure of equipment, breach of representation or warranty (express or implied), ultra-hazardous activity, strict liability, tort, breach of contract, breach of statutory duty, breach of any safety requirement or regulation, or the negligence of any person or party, including the indemnified Party or Parties, whether such negligence be sole, joint and/or concurrent, active or passive, or any other theory of legal liability.

2. Use a “Catch-All Provision” at the end of the indemnity section.

“Except as specifically agreed to the contrary, the parties agree that all indemnities in this Section shall apply without regard to the cause or causes thereof, including, without limitation ...”

In both instances, the Conspicuous Requirement is met through formatting.

3. You can also put a header on page one:

THIS CONTRACT CONTAINS PROVISIONS WHICH INDEMNIFY AND/OR RELEASE THE INDEMNIFIED AND/OR RELEASED PARTY FROM THE CONSEQUENCES OF ITS OWN NEGLIGENCE AND OTHER LEGAL FAULT.
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 the big companies and the—generally smaller—oilfield services contractors.

However, despite the breadth of the language, TOAIA is limited in two important respects.

- It only applies to certain oil and gas contracts.
- It allows for indemnification of the indemnitor’s 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]
- Does NOT include pipelines [§127.001(4)(B)]
- Does not apply to Joint Operating Agreements [§127.001(1)(B)]
- Narrowly construed: must have a close relation to an actual well
III. POTENTIAL UNENFORCEABILITY ISSUES

Texas Oilfield Anti-Indemnity Does Not Apply To:

- Personal injury, death or property damage that results from radioactivity
- Property damage that results from pollution
- Property damage that results from reservoir or underground damage
- Personal injury, death or property damage that results from controlling a wild well
- Cost of control of a wild well
III. POTENTIAL UNENFORCEABILITY ISSUES

TOAIA Insurance Exceptions:

- A provision requiring indemnification for one’s own negligence is valid under TOAIA IF the parties agree in writing that the indemnity obligation will be supported by liability insurance coverage, but:
  - **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

- TOAIA does not prohibit a plan of self-insurance
III. POTENTIAL UNENFORCEABILITY ISSUES

TOAIA Insurance Exceptions:

In *Ken Petroleum Corp. v. Questor Drilling Corp.* the Texas court determined that the amount of insurance coverage actually obtained by the parties is not relevant; the courts look to what the parties agreed in writing to procure.
III. POTENTIAL UNENFORCEABILITY ISSUES

Texas Construction Anti-Indemnity Statute

TEX. INS. CODE § 151.001 et seq.

- The Construction Anti-Indemnity Statute prohibits a person from indemnifying another person from claims or damages caused by the indemnitee’s negligence.
- Indemnity clauses that violate this prohibition are unenforceable and void.
- The statute was created to help lower-tier participants deal with onerous clauses in subcontracts that require them to indemnify prime contractors from even the prime’s own negligence.
Construction Anti-Indemnity Statute Applies To:

- Construction contract for a construction project [§151.101]
- Can include pipelines
III. POTENTIAL UNENFORCEABILITY ISSUES

Construction Anti-Indemnity Statute Exceptions

The following are some of the key exceptions to the statute:

- Agreements subject to TOAIA
- Loan and financing documents, other than construction contracts
- Bodily injury or death of an employee of the indemnitee, its agent or its subcontractor of any tier
- Benefits and protections under workers’ compensation laws
IV. COMMON INDEMNITY SCHEMES IN CONTRACTS

Types of Oilfield Agreements

- Oilfield Service Contracts
- Consulting Agreements for Engineers and other Professionals
- Asset Purchase Agreements for Upstream Assets ("PSAs")
- Midstream Agreements
Who are the counterparties to Oilfield Service Contracts?
Common Indemnity Schemes Used in Oilfield Service Contracts

- Standard/Broad
- Modified
Standard Indemnity Scheme

Each party is responsible for its people and property and that of its respective subcontractors, and indemnifies the other party and its subcontractors of every tier.
IV. COMMON INDEMNITY SCHEMES IN CONTRACTS

**STANDARD INDEMNITY SCHEME**

- Operator
  - Request for Indemnity
  - MSA Knock-For-Knock w/Pass Through

- Service Company No. 1
  - Request for Indemnity
  - MSA Knock-For-Knock w/Pass Through

- Service Company No. 2
  - Request for Indemnity
  - MSA Knock-For-Knock w/Pass Through

- Subcontractor X
  - Request for Indemnity
  - MSA Knock-For-Knock w/Pass Through

- Subcontractor Y
  - Request for Indemnity
  - MSA Knock-For-Knock w/Pass Through

- Injured EE

- Lawsuit for Personal Injury
IV. COMMON INDEMNITY SCHEMES IN CONTRACTS

Modified Indemnity Scheme

- Operator is responsible for its people and property
- Contractor is responsible for its people and property and that of its subcontractors, affiliates, etc.
- Operator’s release only extend to the Contractor
- Contractor’s indemnities extend to Operator and its other contractors, subcontractors, affiliates, etc.
IV. COMMON INDEMNITY SCHEMES IN CONTRACTS

Modified Indemnity Scheme

Under MSA Operator releases only Service Co. 1 for personal injury and property damage of Operator

Service Company No. 1

Under MSA Service Co. 1 releases and indemnifies Operator and its contractors, subcontractor, and affiliates for any claim for personal injury or property damage of Service Co. 1, its contractors, subcontractors, affiliates, etc.

Subcontractor X

Injured EE

Request for Indemnity

Service Company No. 2

Under MSA Service Co. 2 releases and indemnifies Operator and its contractors, subcontractor, and affiliates for any claim for personal injury or property damage of Service Co. 2, its contractors, subcontractors, affiliates, etc.

Subcontractor Y

Under MSA Operator releases only Service Co. 2 for personal injury and property damage of Operator

Lawsuit for Personal Injury
Pollution liability indemnity is usually handled separately from indemnities for personal injury and property damage.

- Pollution liability is one of the greatest sources of potential liability at the wellsite.
- In Oilfield Service Contracts, contractors typically take liability for pollution originating from their equipment.
- Caution should be exercised to avoid overlap of pollution liability allocation provisions and personal injury and property damage allocation provisions.
IV. COMMON INDEMNITY SCHEMES IN CONTRACTS

“Carve Outs” in Oilfield Service Contracts

- Exceptions and limitations to indemnities are often called “carve outs.”
- Post-Macondo, some companies have become very aggressive with carve outs
  - Contractors have been including provisions that denied the operator all remedies other than those specifically granted
  - Operators have been including provisions that carve out gross negligence
- Most common carve out: “except to the extent caused by such party’s sole negligence, gross negligence or willful misconduct.”
- Watch out for switch of “except to the extent” or “unless.”
- Watch for carve-outs of catastrophic situations.
- Contractors frequently want to limit their total indemnity exposure to X% of job.
Consulting Agreements often have a unilateral indemnity scheme in favor of consultant. Often times, the client’s sole remedy is re-performance. Example:

Consultant shall not be liable and Client hereby releases and agrees to indemnity, defend and hold harmless Consultant, its officers, directors, employees and agents (the “Consultant Group”) for any Claims arising from, and Client agrees not to assert any Claims against the Consultant Group arising from or related to, (a) the Services, (b) Consultant Group’s failure to perform any service or make any determination, computation, classification or categorization, or (c) the reliance by Client or any other person on any determination, computation, classification, or categorization made by Consultant Group.
Consulting Agreements for Engineers and other Professionals

Reasons for limited Indemnity and Warranty:

- Consultants are only paid relatively small professional fees.
- Consultant’s work product may be used in the issuance of securities or borrowing of capital.
IV. COMMON INDEMNITY SCHEMES IN CONTRACTS

Asset Purchase Agreements for Upstream Assets

- Seller Indemnity Obligations
- Limitation on Seller Indemnity Obligations
- Buyer Indemnity Obligations
Seller Indemnity Obligations Under PSAs

- Seller is generally required to indemnify Buyer for the following:
  - Retained Liabilities;
  - Any breach of representations or warranties made by Seller under the Agreement; and
  - Any breach of any covenants or agreements of Seller under the Agreement.
Seller’s Retained Liabilities (AKA “Carve-Outs”)

Seller’s retained liabilities generally consist of the following:

- existing claims and litigation;
- claims for personal injury, death and/or property damage arising from operations on the Assets prior to the Closing Date;
- obligations to pay Seller taxes;
- obligations to pay WI, royalties, overriding royalties and other interest owners’ revenues or proceeds, in each case, to the extent attributable to hydrocarbons produced and marketed with respect to the Assets prior to the Effective Time, including suspended revenues;
- obligations and losses arising prior to Effective Time and relating in any manner to the operating expenses of the Assets;
- obligations and losses relating to the prior disposal or transportation of hazardous substances from the Assets to any location not on the Assets in violation of environmental law, including, but not limited to, the Comprehensive Environmental Response, Compensation, and Liability Act of 1980;
- obligations and losses related to the Excluded Assets;
- obligations and losses of Seller in favor of its affiliates arising during the period prior to the Closing Date; and
- obligations and losses arising out of employment relationship with, any of their employees prior to the Closing Date or out of or with respect to any employee benefit plan or under any law with respect thereto.
IV. COMMON INDEMNITY SCHEMES IN CONTRACTS

Limitation on Seller Indemnity Obligations Under PSAs

Seller’s indemnity obligations under PSAs are generally limited by the following:

- Threshold, Deductible, and Cap for Seller Indemnity Obligations
- Survival Periods on Seller Indemnity Obligations
- Exclusive Remedy Clause
Threshold, Deductible and Cap for Seller Indemnity Obligations

- **Individual Claims**
  - Seller is typically not required to indemnify Buyer for any individual Claim less than the Threshold/Deductible
  - Threshold/Deductible varies depending on the Purchase Price

- **Aggregate Claims**
  - Seller is typically required to indemnify Buyer, but only to the extent that the aggregate amount of all qualified individual Claims exceeds the Threshold/Deductible
  - Threshold/Deductible is frequently 1% to 2% of the Purchase Price

- **Cap**
  - Seller is frequently not required to indemnify Buyer for any Claims in excess of twenty five percent (25%) of the Purchase Price

- **Exclusions**
  - Threshold and Deductible typically do not apply to Claims to Retained Liabilities, Fundamental Reps and Warranties, as well as Reps and Warranties for Taxes
Survival Periods on Seller Indemnity Obligations

Seller’s Indemnity Liabilities are often limited under PSAs as follows:

- **Retained Liabilities**: generally not limited by survival period
- **Breach of non-fundamental representations or warranties made by Seller (excluding taxes)**: frequently limited by 12 to 24 months following Closing
- **Breach of representations or warranties made by Seller regarding taxes**: frequently limited to statute of limitations
- **Breach of fundamental representations or warranties made by Seller**: frequently not limited by survival period
- **Any breach of any covenants or agreements of Seller**: frequently limited by 12 to 24 months following post-Closing adjustments
Indemnity Holdback Situations under PSAs

- In certain situations Buyer may desire to holdback a percentage of the purchase price if Seller may not be in a financial position to support its indemnity obligations under the PSA. These may include a private equity company selling all of the Seller’s assets or a 363 sale.

- The holdback will vary depending on the transaction, but is frequently between 10% and 20% of the purchase price.

- Holdbacks frequently last between 6 and 18 months.
Indemnity as Exclusive Remedy Post-Closing

Buyer’s remedy for (i) Seller’s Retained Liabilities, (ii) breach of representations or warranties made by Seller under the Agreement, and (iii) breach of any covenants or agreements of Seller under the Agreement are limited to those indemnities discussed above.
Buyer Indemnity Obligations Under PSAs

Buyer is generally required to indemnify Seller for the following:

- Assumed Liabilities;
- any transfer taxes imposed on Buyer;
- any breach of representations or warranties made by Buyer under the Agreement; and
- any breach of any covenants or agreements of Buyer under the Agreement.

Note: There is generally no limitation of Buyer’s Indemnity Obligations under PSAs.
Buyer’s Assumed Liabilities

Buyer’s assumed liabilities generally consist of the following:

- Pre-Effective Date Environmental Liabilities that are not Retained Liabilities;
- Pre-Effective Date liability under all Material Contracts;
- Payment of pre-Effective Date joint interest costs that are not Retained Liabilities;
- Plugging, abandonment obligations, and decommissioning costs; and
- Pre-Effective Date make-up and balancing obligations.
IV. COMMON INDEMNITY SCHEMES IN CONTRACTS

Midstream Agreements

- Indemnity under Midstream Agreements is frequently possession-based.
- Exception for Off-Spec Commodity.
- Exception for Agreements contemplating construction or frequent access to premises. For example, gathering agreements with “build-out” obligations inter-connect agreements, and tie-back production handling agreements.
Possession-Based Indemnity under Midstream Agreements

- As between the Parties, the Party in possession of the commodity is typically responsible and liable for any and all commodity loss, damages, claims, actions, expenses, liabilities, including reasonable attorney’s fees, injury to and death of Persons, property damage, and environmental damage, pollution, and contamination, caused by, resulting from, the commodity.

- Possession typically transfers from Producer to Gatherer/Processor when the commodity is delivered at the receipt point.
Exception for Off-Spec Commodity in Midstream Agreements

- Producer generally will release, defend, indemnity and hold the Gatherer/Processor harmless from and against Claims arising from Procurer's commodity that does not meet the specifications under the contract.
- Producer will sometimes get exceptions for knowing and continuous acceptance of off-spec commodity by Gatherer/Processor.
- Gatherers/Processors should be cautious of commodity that is on-spec, but contains corrosive materials.
Other Considerations for Indemnities

In this presentation, we have given an overview of what to consider when reviewing an indemnity provision. However, there are a number of other practical issues that should be considered as part of your review outside of the indemnity provision itself.
Other Considerations for Indemnities

Does your contract contain basic insurance protections?

- Waiver of subrogation
- Additional Insured
  - When giving additional insured status, limit to risk expressly assumed by your client under the contract
- Coverage should be primary for assumed risk
- Insurance requirements should work with the indemnities under the agreement
Other Considerations for Indemnities

- Do you even need an indemnity? Are you better off at law?
- Is the indemnity appropriate for what you are trying to cover?
- Is the indemnity enforceable? Other states have oilfield anti-indemnity statutes – Louisiana, Colorado, Wyoming and New Mexico.
- Does the indemnity conflict with other provisions of the agreement?
Porter Hedges LLP

- 110+ lawyer, Houston-based full-service firm established in 1981 with an office in Oklahoma City.

- Business and trial lawyers experienced in a wide range of legal services across a broad spectrum of industries.

- Primary focus on oil and gas representing clients in both transactions and litigation across the full spectrum of the industry.