

Onshore Drilling Contracts: Avoiding the Pitfalls of Form Drilling Contracts

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ONSHORE DRILLING CONTRACTS: AVOIDING THE PITFALLS OF FORM DRILLING CONTRACTS

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I. Introduction*

This paper will address some of the problems and pitfalls in using form onshore drilling contracts and how to avoid them. It will begin with a discussion of the general considerations surrounding the use of form contracts for onshore drilling. This is followed by important risk allocation principles common to all IADC drilling contracts. The paper then addresses specific provisions of the most common and significant IADC onshore contracts, including responsibility for loss, access to the drill site, payment, and related insurance issues with particular emphasis in recent changes to the form. Finally, it makes suggestions for minimizing the risks inherent in using IADC contracts.

II. General Considerations

The International Association of Drilling Contractors (“IADC”)¹ is a world-wide drilling contractor trade organization. Among other things, the IADC drafts and distributes drilling contract forms. These form contracts tend to favor drilling contractors as opposed to operators. Some of the contracts’ problematic provisions are obvious, but others are more subtle and dangerous to the operator. There is no way to re-balance these contracts short of re-drafting them. Consequently, sophisticated parties almost always modify these forms to balance the parties’ rights and to address specific concerns.² Some operators also have their own forms,

* The authors gratefully acknowledge the assistance of Kelly T. Scalise of Liskow & Lewis in the preparation of this paper.

¹ For more information about the IADC, including the availability of contract forms, see the IADC website at “www.iadc.org.”

² Owen L. Anderson, *The Anatomy of an Oil and Gas Drilling Contract*, 25 TULSA LAW JOURNAL 359, 364 (1990).

which frequently include provisions specifically designed to avoid problems encountered in their particular experiences. This paper will concentrate on (but is not limited to) the April 2003 revisions of the onshore daywork, turnkey, and footage contracts. But the discussions in this paper are for the most part applicable to most drilling contracts.

Starting with an IADC form puts an operator at a disadvantage. However, if the operator is not in a position to draft or use its own form, using IADC forms can provide operators with certain benefits. First, IADC contracts are the most commonly used forms, and contractors and operators are generally familiar with their base terms. This makes negotiations somewhat faster because contract managers can immediately focus on key provisions. Second, the IADC forms are broad, detailed, and address many undisputed points. Moreover, the form of the contracts and the wording of their provisions are generally designed to meet many jurisdictions' requirements for enforceability.³

III. Types of Onshore Drilling Contracts

There are three major types of onshore drilling contracts: daywork, footage, and turnkey.⁴ The significant differences among the three relate mainly to how risk is allocated and how the contractor is paid.

A. Daywork

A "daywork" contract provides that the drilling contractor be paid a certain price or rate for work performed as requested by the operator over a twenty-four-hour period with the contractor assuming only certain risks.⁵ A daywork contract is a simple matter of contracting out a drilling rig with a specified crew to an oil and gas operator for a flat daily fee. If problems are encountered in the well, the drilling contractor generally continues to get paid a dayrate for as long as it takes to complete the well.⁶ The amount of the stipulated rate depends on many

³ The IADC forms are designed to meet Texas law standards for most risk allocation issues, but the indemnity scheme may not work without indemnity owed to other contractors. Without modification, the forms are not particularly well-suited to comply with the unique proscriptions on indemnities in Louisiana, Wyoming, or New Mexico.

⁴ Anderson, *supra* note 2, at 374; H. H. Calkins, *The Drilling Contract – Legal and Practical Considerations*, 21 ROCKY MTN. MIN. L. INST. 285, 288 (1975).

⁵ Anderson, *supra* note 2, at 374; Calkins, *supra* note 4, at 288; *Haas v. Gulf Coast Natural Gas Co.*, 484 S.W.2d 127, 131 (Tex. Ct. App. — Corpus Christi, 1972). Whether the drilling operation is accurately stated as being under the "direction and control" of the operator is a question that is debated between operators and drilling contractors.

⁶ During the past decade, there has been a substantial shift away from footage and turnkey contracts to more daywork contracts. In fact, since 2001, more than 75% of the land drilling contracts in the U.S. have been on a daywork basis. This figure is up from less than 45% daywork contracts only a ten years ago. Drilling contractors recognize that daywork drilling operations are generally the least risky, considering the contractor receives a fixed amount of revenue per operating day regardless of how efficiently the hole is drilled. J. Marshall Adkins, *U.S. Land Drilling Update: Bullish Fundamentals for the Indefinite Future*, RAYMOND JAMES OILFIELD SERVICES REPORT, April 5, 2004, at 14.

factors, including market conditions, the type of rig, size of the crew, stage of performance, and specialization of the work. The rate may be proportionately lowered under certain circumstances. For instance, if the rig is on “standby,” salaries of the drilling contractor’s crew continue; however, operating expenses do not accrue. Thus, the standby rate should theoretically be lower than the daywork rate, but that is usually not the case. Under the daywork contract, the driller is responsible for specified risks whereas the operator assumes the general risk of delay and any other performance risks not assumed by the driller. The drilling contractor is usually classified as an “independent contractor.”⁷

B. Turnkey Contracts

Although they vary in form, all turnkey contracts generally have three features in common. First, a turnkey contract has a basic obligation to drill a well to a certain depth or formation. Second, a turnkey contract has a fixed price in which the contractor earns the entire price if the contractor performs and reaches the specific depth and complies with whatever other obligations are included in the “turnkey obligation.” Third, the contractor controls the operation and the drilling methods because the contractor takes the risk of losing the well.⁸

A pure turnkey contract provides the highest risk and highest reward for the contractor. Under this type of contract, a drilling contractor is obligated to drill a complete well for a lump-sum, fixed fee. The contractor assumes all costs and practically all risks of the job, and it contracts with third parties for equipment and services. Thus, operators use turnkey contracts to limit the risk inherent in drilling wells. If there are difficulties during the operation and the turnkey depth is not reached, the contractor is not paid; obviously, the contractor assumes substantially more risk than it does during daywork operations, at least during “turnkey” operations. This risk transfer accounts for the higher cost to the operator of turnkey operations. The reward can be very lucrative for the contractor if the well is completed ahead of schedule and below budget; however, the contractor could also be exposed to significant potential losses.⁹

Despite the name, a turnkey contract usually has the operator responsible for the cost and obligation of completing and equipping the well. A turnkey contract, however, may be tailor-

⁷ Anderson, *supra* note 2, at 374-75; Calkins, *supra* note 4, at 288-89.

⁸ Anderson, *supra* note 2, at 378. The term “turnkey” arose from the obligation historically imposed on the contractor to complete the well for production and turn it over to the operator ready to “turn the key” and start production running, all for the amount stipulated in the contract. The turnkey contract in use today would ordinarily not fit the historical definition because most common turnkey forms generally provide for completion of the well, or plug and abandonment operations, or other work to be performed on a daywork basis. When applied to a particular operation, the term “turnkey” is often used in a way that implies that the project is more or less risk-free for the operator. But the operator often retains substantial risks during a turnkey contract, and the parameters of the risks being retained by the operator should be carefully examined. See generally William W. Pugh, *The IADC Offshore Drilling Contract*; 44 ROCKY MT. MIN. L. INST. II (1998).

⁹ J. Marshall Adkins, *U.S. Land Drilling Update: Bullish Fundamentals for the Indefinite Future*, RAYMOND JAMES OILFIELD SERVICES REPORT, April 5, 2004, at 14.

made to particular drilling conditions, placing specified risks on the operator and providing additional compensation to the drilling contractor.¹⁰

C. Footage Contracts

A “footage” contract basically provides that the drilling contractor furnishes the drilling crew, drilling equipment, and certain specified services, and is paid an agreed sum of money for each foot actually drilled; the drilling contractor receives a stipulated price per foot of hole drilled from the surface to a certain depth or to some specified objective. The contractor assumes more of well-related risk under a footage basis than under a daywork contract, which is balanced by a somewhat higher cost to the operator. If the contractor is able to drill more efficiently than projected, the profitability of that contract improves. But if the well encounters problems and costs more per foot of well drilled, the drilling contractor picks up the added cost and may lose money.

Daywork compensation rates may apply when the drilling is suspended or delayed. If daywork rates apply, then so do the risk allocation provisions of a daywork contract. Thus, it is important to specifically define in a footage contract when daywork rates apply.¹¹ Because the drilling contractor is only paid for footage drilled and for specified daywork, and because the contractor assumes more risk, the footage contract may be more advantageous for the operator.

Under all forms, the operator will generally reserve the right to order that drilling cease at any point in time. The contractor’s right to stop drilling, however, is more limited. Generally, a contractor may stop drilling if there is concern over the operator’s solvency, if the operator has failed to compensate the contractor in a timely manner, or if unanticipated problems arise beyond the contractor’s control.¹²

IV. Risk Allocation issues Common to all Three Types of Drilling Contracts

Drilling operations can be dangerous to both personnel and property. A blowout, for example, can result in tremendous exposure to liability for property damage, personal injury, pollution, and other damages.¹³ A proper risk allocation scheme – including indemnity, insurance, and other contractual provisions – can mitigate the effects of casualty risks, foster certainty in the case of an accident, and reduce litigation costs. And understanding basic risk

¹⁰ Pete Griffis & Carmen Rodriguez, *Turnkey Drilling Contracts From the Operator’s Perspective*, LOUISIANA INDEPENDENT OIL AND GAS ASSOCIATION NEWSLETTER (1998).

¹¹ Anderson, *supra* note 2, at 377-78. The same issue exists under turnkey contracts as well. Although switching to daywork while under a turnkey contract occurs much less often, the potential consequences – in terms of altering performance risk and liability risk – are even more significant in the footage contract.

¹² Anderson, *supra* note 2, at 385; Calkins, *supra* note 4, at 288.

¹³ Anderson, *supra* note 2, at 440; *see, e.g., Smith v. Cudd Pressure Control, Inc.*, 126 S.W.3d 106 (Tex. App. – Houston [1st Dist.], 2003); *Brooks Well Servicing, Inc. v. Cudd Pressure Control, Inc.*, 860 So. 2d 1157 (La. 2003).

allocation principles common to IADC form drilling contracts is essential to negotiating acceptable contracts and protecting your clients' interests.

A. Indemnification

1. General Indemnity Scheme in IADC Insurance Contracts

The basic risk allocation scheme of the IADC forms is a broad reciprocal indemnity for bodily injury, property damage, certain pollution risks, and consequential damages, regardless of fault. In the absence of modification, the release, defense, and indemnity obligations extend to the operator's affiliated entities, partners, employees, etc., but not the operator's other contractors, which can be a very significant issue. Other risks, such as well control, downhole pollution, downhole tools, loss or damage to the hole, and reservoir damage, are often assumed by the operator, at least to some degree, while on daywork. While working on a turnkey or footage basis, the contractor generally assumes a significant portion, but not all, of the well-related risk.¹⁴

In addition to the foregoing, the IADC contracts include various "carve-outs" for the basic reciprocal indemnity. For example, the operator is asked to assume liability for loss or damage to the drilling rig as a result of location problems and liability for loss or damage to downhole tools. The scope of these carve-outs as respects both amount and whether they apply regardless of the contractor's negligence is a critical negotiation issue for an operator.

The most critical protection to obtain is the so-called "pass through" indemnity. Without express language, an indemnity provision will not be interpreted to cover the indemnitee's contractual liability to a third party.¹⁵ Thus, if an operator/indemnitee has itself agreed to indemnify another party for personal injury claims to the operator's other contractors' employees, and the other party (*e.g.*, drilling contractor) is sued, the indemnity from the employer/drilling contractor may not cover the operator/indemnitee's contractual liability to the third party. The absence of a pass-through in one of the operator's underlying contracts will mean that the operator owes indemnity to the drilling contractor for the drilling contractor's fault with no corresponding indemnity from its other contractor.¹⁶ In addition, even if the "pass-through" provision is present in the underlying contract, it is not uncommon to find that the indemnities in the underlying contract are not enforceable under the Louisiana Oilfield Indemnity Act or the Texas Anti-Indemnity Act.

Obtaining protection for a contractual indemnity obligation requires a specific provision. The best way to achieve this "pass-through" is to expand the categories of persons or companies entitled to indemnity protection to include the indemnitee's contractors and subcontractors. This

¹⁴ Please refer to Section V(B) of this paper for a more detailed discussion of risk allocation in turnkey contracts.

¹⁵ *Foreman v. Exxon Corp.*, 770 F.2d 490 (5th Cir. 1985); *Corbitt v. Diamond M Drilling Company*, 654 F.2d 329 (5th Cir. 1981).

¹⁶ *Foreman*, 770 F.2d at 495.

new collection of indemnified parties can be concisely referred to as “Operator Group.” This approach will enable the operator to “pass-through” its indemnity protection to third parties.¹⁷

2. Enforceability and Scope

Another important consideration with respect to the indemnity provisions is to ensure the correct scope, enforceability, and compatibility with the insurance scheme. The indemnity sections in the IADC forms are generally sufficient in scope and form to clearly set forth the parties’ intent and to meet the requirements of most jurisdictions for enforceability.¹⁸

Those paragraphs addressing the general intent of the indemnity scheme (*e.g.*, Paragraph 14 of the daywork contract and Paragraph 19 of the footage form, and Paragraph 18 of the turnkey form) clearly and unequivocally express the intent that the indemnitee be indemnified for its own negligence.¹⁹ This means that the IADC contract should pass muster under all states’ laws, including the Texas “express negligence” rule.²⁰ The contract headers state in bold, capitalized letters, “This contract contains provisions relating to indemnity, release of liability, and allocation of risk.” Combined with subheadings and the bolded (and sometimes red) text of the indemnity provision, as well as red ink text near the signature blocks, there should be no question that the contracts meet the Texas “conspicuousness” rule.²¹ Consequently, the forms do not need major changes to their basic risk allocation structure to comply with Texas law. Nonetheless, certain modifications should be made to maximize protection to the operator from an indemnity scheme standpoint²² and from a potential anti-indemnity standpoint.

¹⁷ An alternative is to require indemnity protection for any contractual liability to third parties. Another alternative is to specify that the indemnity obligation is owed to the indemnitee and anyone to whom the indemnitee owes contractual indemnity. For an illustration of an effective “pass-through,” see *Campbell v. Sonat Offshore Drilling, Inc.*, 979 F.2d 1115 (5th Cir. 1992).

¹⁸ An important exception is where anti-indemnity statutes invalidate provisions that impose liability on a party with regard to fault.

¹⁹ *Cleere Drilling Co. v. Dominion Exploration & Prod., Inc.*, 351 F.3d 642 (5th Cir. 2003); see also Harold J. Flanagan and Bryan C. Reuter, *Purchase Order Contracts: A Whole Lot More Than You Bargained For?*, 46 LOYOLA LAW REVIEW 365, 384 (2000).

²⁰ The Texas Supreme Court in *Ethyl Corporation v. Daniel Construction Company*, 725 S.W.2d 705 (Tex. 1987), created the “express negligence doctrine” and stated that the intent to indemnify the indemnitee for his own negligence must be stated in specific terms. See also *Cleere Drilling*, 351 F.3d at 647.

²¹ The Texas Supreme Court in *Dresser Industries v. Page Petroleum, Inc.*, 853 S.W.2d 505 (Tex. 1993), has held that indemnity provisions and releases must be “conspicuous” and has adopted the standard for conspicuousness provided in the Texas Uniform Commercial Code. See Tex. Bus. & Com. Code Ann. § 1.201(10) (Vernon 1988) (Tex. U.C.C.); see also *Cleere Drilling*, 351 F.3d at 647.

²² Please refer to Section IV(A) of this paper for a discussion regarding the need for pass-through, indemnity protection, and avoiding floating magic language.

3. Anti-indemnity Acts

Four states – Louisiana, Texas, New Mexico, and Wyoming – have enacted anti-indemnity statutes to prohibit one party to a contract related to oil and gas operations from requiring the other to protect the indemnitee for its own fault.²³ These statutes are based on a perception of inequity to contractors or a presumption that forcing each party to bear losses according to its own degree of fault will promote safety. An awareness of these statutes and how they operate is essential to planning risk allocation for drilling operations in affected states, inasmuch as the normal indemnity scheme in the IADC forms may be nullified by the anti-indemnity acts.²⁴

In Louisiana, the Louisiana Oilfield Indemnity Act (“LOIA”) invalidates indemnification agreements “pertaining to a well” for death or bodily injury only.²⁵ Indemnity and insurance protection for property damage indemnity agreements remain unaffected by the LOIA. And in Louisiana, the courts have expressly relied on the language of the LOIA as only applying to agreements “pertaining to a well” in adopting a somewhat limiting two-step process for determining whether the LOIA applies.²⁶ If the LOIA does apply, there are few exceptions,²⁷ but one of the exceptions applies to farmout agreements and JOAs.²⁸ The LOIA invalidates any contractual insurance requirements,²⁹ and this has been interpreted as prohibiting any insurance protection unless the indemnitee/additional insured pays “all material costs” of extending such

²³ Anderson, *supra* note 2, at 439; Pugh, *You Can’t Always Get What You Want, But You Can Avoid Costly Mistakes: Insurance Issues for Oil & Gas Operators*, 45 ROCKY MT. MIN. L. INST. § 10.06[1][a] (1999).

²⁴ Patrick S. Ottinger, DRILLING CONTRACTS, 38 LA. MIN. LAW INST. 101, 146-49 (1991).

²⁵ Pugh, *supra* note 21, at § 10.05[2][a]; *see also* La. Rev. Stat. Ann. 9:2780 (West 1991 & Supp. 1999).

²⁶ *See, e.g., Lloyds of London v. Transcontinental Gas Pipe Line Corp.*, 38 F.3d 193 (5th Cir. 1994); *Fontenot v. Chevron U.S.A.*, 676 So. 2d 557 (La. 1996); *Verdin v. Ensco Offshore Co.*, 255 F.3d 246 (5th Cir. 2001) (LOIA applies to contract to refurbish fixed drilling rig that was designated to drill several wells in the future).

²⁷ For instance, the LOIA does not permit contractual contributions under a contract subject to the LOIA even indemnity for the comparative fault of the indemnitor is unenforceable. *Meloy v. Conoco, Inc.*, 504 So. 2d 833 (La. 1987). But costs of defense can be recovered if there is no negligence or fault on the part of the indemnitee, *id.* at 839, and the potential impact of this problem has apparently been largely eliminated by the elimination of solidary (joint and several) liability. *See* La. Civ. Code Ann. art. 2323 (West 1997 and Supp. 1999); Pugh, *supra* note 8, at § V.B.

²⁸ La. Rev. Stat. Ann. § 9:2780(D)(2)(a) (West 1991 & Supp. 1999).

²⁹ Subsection G invalidates any contractual requirement that a party be named as an additional insured or be granted a waiver of subrogation if there is negligence on the part of the indemnitee. *Babineaux v. McBroom Rig Bldg. Serv., Inc.*, 806 F.2d 1282 (5th Cir. 1987).

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additional insured protection under *Marcel v. Placid Oil Company*. If the *Marcel* exception applies, then the LOIA does not invalidate the additional insured protection.³⁰

The Texas Oilfield Anti-Indemnity Act (“TOAIA”) applies to property damage claims as well as claims for bodily injury or death.³¹ Like the LOIA, the TOAIA applies to agreements pertaining to a well or mine although certain agreements like those for purchasing, selling, gathering, or storing, or transporting gas or natural gas liquids by pipeline or fixed associated facilities are excluded.³² As in Louisiana, the Texas Act applies to agreements pertaining to a well or to a mine, although certain agreements are specifically excluded,³³ and there is an exception for JOAs as well.³⁴ The TOAIA, and the jurisprudence interpreting it, provide for several exceptions to the proscription against indemnity and insurance protection. Unlike the LOIA, the TOAIA allows exceptions if the parties agree, in writing, that the indemnity will be supported by insurance.³⁵ The first exception is the unilateral indemnity, which is valid up to \$500,000 if the parties agree in writing that the indemnity obligation will be supported by insurance.³⁶ The second exception is the mutual indemnity exception, which provides that each party must agree in writing to obtain insurance in favor of the other party as indemnitee.³⁷

Significantly, the TOAIA does not apply to insurance that does not directly support the indemnity,³⁸ and this means that insurance provisions can provide more protection than indemnity agreements in certain instances. A *Getty* provision (named after *Getty Oil Company v. Insurance Company of North America*³⁹) allows for insurance protection that does not directly

³⁰ 11 F.3d 563 (5th Cir. 1994). For a detailed discussion of the *Marcel* exception to the LOIA, see Pugh, *supra* note 8, at § V.B.

³¹ Tex. Civ. Pract. & Rem. Code Ann. 127.003(a)(2) (Vernon 1997).

³² Tex. Civ. Pract. & Rem. Code Ann. 127.001(4)(B)(i); see also Pugh, *supra* note 21, at § 10.05[2][b].

³³ Tex. Civ. Prac. & Rem. Code § 127.001(4)(B)(i) (Vernon 1997) specifically excludes purchasing, selling, gathering, storing, or transporting gas or natural gas liquids by pipeline or fixed associated facilities.

³⁴ Tex. Civ. Prac. & Rem. Code Ann. §§ 127.001(1)(B) & 127.002 (c) (Vernon 1997).

³⁵ Tex. Civ. Prac. & Rem. Code Ann. § 127.005 (c) (Vernon 1997) allows a unilateral indemnity up to \$500,000, and a mutual indemnity is enforceable up to the amounts of insurance or qualified self-insurance that each party agrees to provide for the “benefit of the other party as indemnitee.” *Id.* at § 127.005 (b). Section 127.001(6) also defines a “unilateral indemnity obligation” as one in which the indemnitor agrees to indemnify the indemnitee for personal injury or death to the employees of the indemnitor or of the indemnitor’s contractors, with no reciprocal indemnification by the indemnitee to the indemnitor.

³⁶ Tex. Civ. Pract. & Rem. Code Ann. § 127.005(b).

³⁷ *Id.*; see Pugh, *supra* note 21, at § 10.05[2][b].

³⁸ *Certain Underwriters at Lloyds London v. Oryx Energy Co.*, 142 F.3d 255 (5th Cir. 1998); *Getty Oil Company v. Ins. Co. of North America*, 845 S.W.2d 794 (Tex. 1992), *cert. denied sub nom. Youell & Cos. v. Getty Oil Co.*, 510 U.S. 820 (1993).

³⁹ *Getty*, 845 S.W.2d at 804-05. For a detailed discussion of the *Getty* exception to the Texas Anti-Indemnity Act, see Pugh, *supra* note 8, at V.C.

support an invalid indemnity obligation. Taking advantage of *Getty* requires the contract to have two insurance provisions, one supporting the indemnity and a separate insurance obligation, *i.e.*, one not supporting what may otherwise be an invalid indemnity.

The Wyoming anti-indemnity act (the “Wyoming Act”)⁴⁰ also applies to both personal injury and property damage claims. Its stated scope is generally the same as the TOAIA, invalidating any agreement pertaining to any “well for oil, gas or water, or mine for any mineral” to the extent such contract “purports to relieve the indemnitee from loss or liability for his own negligence.”⁴¹ But the Act has generally been rather narrowly interpreted. In several cases, the Wyoming courts have refused to apply the Act to indemnity agreements unless the contract directly related to the drilling of a well as opposed to other well services.⁴² While the Wyoming Act has an insurance exception, which states that it “shall not affect the validity of any insurance contract or any benefit conferred by the Worker’s Compensation Law,” there appear to be no reported Wyoming cases interpreting that provision. The Wyoming Act has been interpreted as allowing partial indemnity when an indemnitee is not negligent.⁴³

The Wyoming Act does not address JOAs, but the Wyoming Supreme Court, in *Bolak v. Chevron, U.S.A.*,⁴⁴ has applied section 30-1-131 to void an agreement in a Unit Operating Agreement that would have allowed an operator to recover from the non-operators their proportionate share of the costs of settling a personal injury suit.⁴⁵ In light of the decision in *Bolak*, an operator in Wyoming may have difficulty sharing liabilities with its non-operators as normally contemplated by the JOA.

⁴⁰ Wyo. Stat. Ann. § 30-1-131 (Michie 1998).

⁴¹ Wyo. Stat. Ann. § 30-1-131(a) (Michie 1998); *see Northwinds of Wyo., Inc. v. Phillips Petroleum Co.*, 779 P.2d 753 (Wyo. 1989); *Mountain Fuel Supply Co. v. Emerson*, 578 P.2d 1351 (Wyo. 1978); *Heckart v. Viking Exploration, Inc.*, 673 F.2d 309 (10th Cir. 1982); *Hull v. Chevron U.S.A., Inc.*, 812 F.2d 590 (10th Cir. 1987).

⁴² *R&G Electric, Inc. v. Devon Energy Corp.*, 53 F. App. 857 (10th Cir. 2002) (Where contractor performed work on a pump well downstream of the well, the Wyoming Anti-Indemnity Act would not apply because the services of the electricians were not closely connected to well drilling, and therefore the indemnity provision did not offend Wyoming law. Consequently, the law of Oklahoma, which was selected by the parties, would apply to the interpretation of the indemnity provision at issue.); *Union Pacific Resources Co. v. William Dolenc, d/b/a Dolenc Welding Service*, 86 P.3d 1287 (Wyo. 2004) (Wyoming Anti-Indemnity Statute did not apply to work performed at a water plant used to enhance oil production because the statute only applies to contracts for work performed directly on an oil, gas, or water well.).

⁴³ *Cities Serv. Co. v. Northern Prod. Co.*, 705 P.2d 321, 328 (Wyo. 1985); *Hull*, 812 F.2d at 592; *see also Pugh, supra* note 21, at § 10.05[2][c].

⁴⁴ 963 P.2d 237, 241 (Wyo. 1998).

⁴⁵ *Id.* at 241. In *Bolak*, the court stated that the strong public policy underlying the Wyoming Act was to promote safety and that allowing the operator’s claim under the Unit Operating Agreement would thwart that public policy.

The New Mexico anti-indemnity act (the “New Mexico Act”)⁴⁶ also applies to claims for both personal injury and property damage, and the scope is similar to the Texas and Wyoming anti-indemnity acts.⁴⁷ The New Mexico Act does not include any specific exception for JOAs, but arguably the allocation of liability under a JOA is not the type of agreement that the Act was intended to prohibit.⁴⁸ This is because under a JOA, the operator is performing operations on behalf of the non-operators, as would a managing partner of a partnership, and the JOA simply requires all participants to bear their share of joint expenses (including liabilities). That is significantly different from the situation in which one company hires another to perform a service, which is the context in which the anti-indemnity statutes have generally been applied. There is no exception for insurance coverage under the New Mexico Act.⁴⁹

4. Choice of Law Provisions

Attempting to avoid the effects of these acts by selecting the law of another jurisdiction as controlling can be problematic. In Louisiana, for example, Civil Code Article 3540 provides that choice of law provisions in contracts may only be enforced when they do not conflict with the state’s public policy.⁵⁰ It is the public policy of Louisiana that the state whose laws are sought to be applied in a contract must have some significant relationship to the parties or the contract.⁵¹ The choice of law provision is given effect unless there is statutory or jurisprudential law to the contrary or strong public policy considerations that justifies the refusal to honor the contract as written.⁵² The party who seeks to invalidate such a provision based on public policy bears the burden of proof, and must show “an express legislative or constitutional prohibition or a clear showing that the purpose of the contract contravenes good morals or public interest.”⁵³ Mere differences in laws is not a violation of public policy.⁵⁴ On the other hand, where the public policy of the state whose law would otherwise apply would be violated by the application of a choice of law provision, the choice of law provision will generally not be enforced, and the anti-indemnity statutes have generally been considered to be statements of public policy that

⁴⁶ N.M. Stat. Ann. 56-7-2 (Michie 1999).

⁴⁷ The New Mexico Act does not prevent indemnity for the partial fault of the indemnitor even if the indemnitee is also partially at fault. *Guitard v. Gulf Oil Company*, 670 P.2d 969, 972 (N.M. Ct. App. 1983); cf. *Meloy v. Conoco, Inc.*, 504 So. 2d 833 (La. 1987).

⁴⁸ *But see Bolak*, 963 P.2d at 241; and Pugh, *supra* note 21, at § 10.05[2][c].

⁴⁹ N.M. Stat. Ann. 56-7-2(c); *Amoco Prod. Co. v. Action Well Service*, 755 P.2d 52, 55-56 (N.M. 1988).

⁵⁰ La. Civ. Code Ann. art. 3540 (West 1994).

⁵¹ Flanagan & Reuter, *supra* note 17, at 377; *see also Stoot v. Fluor Drilling Servs. Inc.*, 851 F.2d 1514 (5th Cir. 1988); *Lafayette Stabilizer Repair, Inc. v. Machinery Wholesalers Corp.*, 750 F.2d 1290 (5th Cir. 1985).

⁵² *Associated Press v. Toledo Invs., Inc.*, 389 So. 2d 752 (La. App. 3rd Cir. 1980).

⁵³ Flanagan & Reuter, *supra* note 17, at 377; *see also Meinerz v. Treybig*, 245 So. 2d 557, 559 (La. App. 3rd Cir.), *writ denied*, 247 So. 2d 395 (La. 1971).

⁵⁴ Flanagan & Reuter, *supra* note 17, at 378; *see also Stoot*, 851 F.2d at 1518; *Rodrigue v. LeGros*, 563 So. 2d 248 (La. 1990).

cannot be altered by a choice of law provision.⁵⁵ It should be noted that the applicable law for a tort claim, usually the law of the place of the accident, may be different than the result of choice of law rules governing contract issues.⁵⁶

B. Insurance Requirements

The boilerplate insurance provisions in the IADC forms (including those found in Exhibit “A”) provide a substantial basis for a good insurance protection, but important improvements should be made to avoid unforeseen problems and as a back stop to potentially voidable indemnity provisions.

As for the kinds and amounts of insurance indicated in Exhibit “A,” the amount of coverage provided must be adjusted to account for any special risks involved in the operations, the cost of the rig, and the particular jurisdiction(s). The excess insurance should be designated as being on an umbrella form or “no less broad than primary” to avoid possible gaps created by non-following form excess coverage.⁵⁷ In addition, if Texas law may apply, the protections afforded by the drilling contractor’s insurance should be required to be provided for all of the contractor’s insurance policies related to the work – not just those required by the contract – to maximize the opportunity to comply with the *Getty* case.

From an insurance coverage standpoint, there are three critical protections that should be obtained in the contract.⁵⁸ First, the operator should be named as an additional insured in all of

⁵⁵ *Roberts v. Energy Development Corp.*, 235 F.3d 935 (5th Cir. 2000) (court held that a Texas choice of law provision was invalid as applied to a Louisiana contractor under Louisiana’s conflicts rules because its application would offend the public policy of Louisiana as expressed in the LOIA); *but see Reagan v. McGee Drilling Corp.*, 933 P.2d 867 (N.M. Ct. App.), *cert. denied*, 932 P.2d 498 (N.M. 1997) (court held that a Texas choice of law clause was enforceable, despite the absence of any similar exception under New Mexico’s anti-indemnity statute, because the two states’ policies were the same, to promote safety, even though Texas’ statute was less strict; however, N.M. Stat. Ann. 57-7-2(c), which negates insurance coverage, could alter this result and make enforcement problematic).

⁵⁶ *Anderson*, *supra* note 2, at 461. In *Chesapeake Operating, Inc. v. Nabors Drilling USA, Inc.*, 94 S.W.3d 163 (Tex. App.—Houston [14th Dist.], 2002), the court applied Texas law to an indemnity claim for personal injury claims that arose out of an accident in Louisiana. The contract was a daywork drilling contract with mutual indemnity provisions that were to be supported with insurance. Under Texas law, the indemnity was valid whereas under Louisiana law, the indemnity was not. The court looked to Texas conflict of laws rules. The parties had chosen Texas law, but the court was required to determine if Louisiana had a more significant relationship, if the application of Texas law contravened any Louisiana public policy, and if Louisiana had a materially greater interest in the issue. The court found that Texas had the more significant relationship as one party was domiciled in Texas, the contract had been negotiated in Texas, and Texas was the place of performance of the indemnification obligation because the underlying suit, for which indemnity was being sought, had been filed in Texas.

⁵⁷ The turnkey and footage forms do not specifically require excess insurance; it must be written in to Exhibit “A.”

⁵⁸ Two of these protections, additional insured status and waiver of subrogation, are already contained in all three IADC forms.

the contractor's insurance policies,⁵⁹ at least for the risks and liabilities assumed by the contractor. The additional insured status gives the operator direct rights against the contractor's insurer, increases the operator's "moral authority" in a coverage dispute, and possibly enhances the operator's rights to recover against the contractor's insurer for bad faith. The standard additional insured provision also increases the available pool of insurance protection available for a casualty and insulates the operator's insurance program from a reduction of its limits.⁶⁰ In addition, the operator should consider requiring that the additional insured provision specify a particular form (for example, ISO form CG 20 10 AI) to guard against the possibility of an overly restrictive additional insured endorsement.

Second, the contract should also require a waiver of subrogation in all policies. The waiver of subrogation prevents the contractor's insurer from asserting a claim against the identified party for its share of fault for a casualty. Sometimes a waiver of subrogation can provide more protection than being named additional insured.⁶¹ A waiver of subrogation is especially important in a drilling contract because of the magnitude of the property damage risk and the possibility that the operator's liability coverage might exclude damage to drilling rigs and related equipment.

Third, the contractor's insurance should be specifically designated as "primary and non-contributory" to any insurance available to the operator (or any other protected parties). Without such a statement, the contractor's insurer may attempt to rely on its policy's "other insurance" clause to reduce or even avoid coverage altogether. The statement of primary coverage merely reinforces the parties' intent, and may, therefore, blunt an argument that the contractor's insurance was actually intended to act as co-insurance with the operator's coverage, such that the "other insurance" clause in the contractor's policy requires a contribution from the operator's policy.⁶²

⁵⁹ Pugh, *supra* note 21, at § 10.06[1][a]. On some types of policies, including worker's compensation and professional liability, additional insured protection is unavailable. Nevertheless, the operator should insure that such policies provide for a waiver of subrogation and statement of primary coverage.

⁶⁰ Additional insured protection is most effective in a liability policy, while the waiver of subrogation is most common in conjunction with property policies and workers' compensation policies.

⁶¹ See *Marathon Oil Co. v. Mid-Continent Underwriters*, 786 F.2d 1301 (5th Cir. 1986) (where the contractor's insurer paid 100% of a judgment, and the operator, as additional insured, was only covered under the policy for a portion of that liability, the contractor's insurer nevertheless could not recover the uninsured portion from the operator by way of subrogation because the insurer had waived subrogation against the operator).

⁶² *Hodgen v. Forest Oil Corporation*, 862 F. Supp. 1567 (W.D. La. 1994), *aff'd in part, questions certified to Louisiana Supreme Court*, 87 F.3d 1512 (5th Cir. 1996), *cert. quest. denied*, 681 So. 2d 354 (La. 1996), *aff'd*, 115 F.3d 358 (5th Cir. 1997). In *Hodgen*, the operator was covered as an additional insured under a contractor's liability policy. The district court, however, held that the liability was covered under both the operator's insurance policy and the contractor's insurance policy. But there was no provision in the contract requiring that the contractor's policy be primary. Consequently, when the court concluded that the contractor's policy had a stronger

In addition to the foregoing, all three protections – additional insured, waiver of subrogation, and primary coverage – should be extended to all of the operator-related indemnified parties, e.g., “Operator Group.”⁶³ This step protects against the contractor’s insolvency. It can also be critically important because sometimes the contractor’s indemnity obligations may be invalid, but insurance protection may be fully enforceable. A sophisticated contractor will likely insist that insurance coverage will be provided only to the “extent of the indemnity obligations undertaken by Contractor hereunder.” This is a reasonable request, as it prevents the contractor’s insurance program from being overtaxed from a loss it had not bargained for. Of course, if the operator is required to provide insurance coverage in favor of the contractor, a similar qualification should apply. In addition, the qualification should relate to the “risks and liabilities” assumed, not the indemnity obligations, to avoid any question concerning whether the obligation must be enforceable to trigger the insurance obligation.⁶⁴ In *Certain Underwriters at Lloyds London v. Oryx Energy Co.*,⁶⁵ the court properly rejected such an argument, but avoiding a reference to “indemnity obligations” may avoid the issue altogether.

Finally, there are other insurance requirements that should also be included. The contract should require that proper territorial limits are in place for the applicable coverages, that the operator will receive thirty days notice of cancellation or material change, and that the operator will receive a certificate of insurance evidencing that the required coverages are in place.⁶⁶ The operator should be wary of certificates that limit the requirement for notice of cancellation or that purport to limit the right to rely on the certificate.⁶⁷ If possible, the operator should consider using its own form of certificate of insurance to facilitate review of compliance with the insurance requirements. Finally, the insurance requirements should state that the minimum limits are not a limitation or restriction on indemnity⁶⁸ and should include any specific provisions required as a result of a potentially applicable anti-indemnity statute.⁶⁹

“other insurance” clause (an “escape clause”), the operator could not recover anything from the contractor’s insurers and was limited to coverage under its own insurance policies.

⁶³ Please refer to Section IV(A) of this paper for the importance of obtaining protection for all indemnified parties.

⁶⁴ *Certain Underwriters at Lloyds London v. Oryx Energy Co.*, 142 F.3d 255 (5th Cir. 1998).

⁶⁵ 142 F.3d 255 (5th Cir. 1998).

⁶⁶ The IADC forms require only a ten-day notice, which might not give the other party sufficient time to react.

⁶⁷ *TIG Ins. Co. v. Sedgwick James of Washington*, 276 F.3d 754 (5th Cir. 2002) (issuance of the certificate of insurance on the standard Acord form did not create either a cause of action against the insurance agent or coverage because Sedgwick did not have the authority to alter coverage and because the certificate disclaimed any power to alter coverage).

⁶⁸ *Dickerson v. Continental Oil Co.*, 449 F.2d 1209 (5th Cir. 1971), *cert. denied sub nom. Ins. Co. of North America v. Continental Oil Co.*, 405 U.S. 934 (1972).

⁶⁹ As explained in Section IV(A)(3) of this paper, if required by Texas law, minimum limits should be established for a Texas “unilateral” indemnity, or if the contract includes a Texas “mutual” indemnity, the contract should include a reference to minimum insurance or self insurance limits

C. Other Protections

1. Independent Contractor

An independent contractor provision – reciting that the contractor is hired as an independent contractor (not as an agent) and that the operator is interested only in the results obtained – can help minimize risks due to negligence claims by emphasizing that the contractor is in charge of the specific details of the work.⁷⁰ A successful “independent contractor defense” will relieve the principal from liability where the principal contracts with another to handle the details of operations.⁷¹ This additional protection can be particularly important if the indemnity or insurance protection owed to the operator is unenforceable because of an anti-indemnity statute. The 2003 IADC daywork form states in its preamble that the contractor will perform the operations as an independent contractor, but there is no independent contractor provision. The footage and turnkey forms, however, have generally satisfactory independent contractor provisions.

2. Statutory Employer

Under Louisiana law, a company that meets the definition of a “statutory employer” is entitled to immunity from tort claims asserted by its “statutory employees.” Louisiana Revised Statute 23:1061(A)(1) defines a principal (or “statutory employer”) as anyone who undertakes to execute any work which is a part of his trade, business, or occupation and contracts with any

equally applicable to both parties (under prior law) or comply with the requirements of the recent amendment. In addition, provisions should be added to comply with *Getty*. See Pugh, *supra* note 21, at § 10.05[2][b]; see generally Pugh, *supra* note 8, at § V.C. (discussing the insurance requirements under the Texas Anti-Indemnity Act). If Louisiana law may apply, a provision complying with *Marcel* should be considered. See Pugh, *supra* note 21, at § 10.05[2][a]; Pugh, *supra* note 8, at § V.B.

⁷⁰ A sample provision is as follows:

Contractor shall at all times be an independent contractor, and nothing in this Contract shall be construed as creating the relationship of principal and agent, or employer or employee, between Operator and Contractor or between Operator and Contractor’s agents or employees. Contractor shall have no authority to hire any persons on behalf of Operator, and any and all persons whom Contractor may employ shall be deemed to be solely the employees of Contractor. Contractor shall have control and management of the Work, the selection of employees and the fixing of their hours of labor, and no right is reserved to Operator to direct or control the manner in which the Work is performed, as distinguished from the result to be accomplished. Nothing herein contained shall be construed to authorize Contractor to incur any debt, liability, or obligation of any nature for or on behalf of Operator.

⁷¹ *Coulter v. Texaco, Inc.*, 117 F.3d 909, 912 (5th Cir. 1997); *Hoechst-Celanese Corporation v. Mendez*, 967 S.W.2d 354 (Tex. 1998); *Howarton v. Minnesota Mining and Manuf., Inc.*, No. 11-02-00280, 2004 WL 743710 (Tex. App. – Eastland, April 8, 2004); *Beham v. Southwest Calibration Serv., Inc.*, No. 01-97-00032, 1998 WL 1114369 (Tex. App. – Houst. [1st Dist.], 1998).

person for the execution by or under the contractor of the whole or any part of the work undertaken by the principal. Section 23:1061(A)(1) also states that work shall be considered part of the principal's trade, business, or occupation "if it is an integral part of or essential to" the ability of the principal to generate its goods, products, or services. But Louisiana Revised Statute 23:1061 also provides that, except in those instances covered by the two-contract theory, a statutory employer relationship "shall not exist . . . unless there is a written contract between the principal and a contractor which is the employee's immediate employer or his statutory employer, which recognizes the principal as a statutory employer."⁷² Accordingly, such a provision should definitely be added to any IADC drilling contract being performed in Louisiana. With a statutory employer provision in the contract, there is a rebuttable presumption of statutory employer status. That presumption may be overcome only by showing the work is not integrally related or essential to the ability of the principal to generate its goods, products, or services.⁷³

3. Savings/Severability Clause

A savings clause should be included in any drilling contract, especially where an anti-indemnity act might apply. It is dangerous to assume that a court will simply read an illegal clause out of the contract. When faced with an illegal requirement in a provision, the court may invalidate the whole clause, not just the specific offending portion. In addition, an operator should consider a "flexible" savings clause, one that provides that the contract provision in question shall be deemed amended to the extent – but only to the extent – necessary to remove the illegality. While the IADC turnkey form contract contains a "specific" savings clause in the indemnity provision itself, a general savings clause can be more flexible and potentially provide the operator with more protection. The footage and daywork contracts have no savings clause, however.

4. Protection from Liens

The contractor should be required to ensure that all of its subcontractors and suppliers are paid promptly and no liens will be filed against Operator Group or its property. And if a lien is asserted, the contractor should be required to remove it immediately and to indemnify Operator Group from any loss. After all, the operator hired a single drilling contractor for the project in part to avoid having to deal with subcontractors. The daywork form has no requirement for the contractor to prevent liens or to remove them, and the form should be modified to include one.⁷⁴ The contractor will usually agree to such a provision, provided it contains an exception for the contractor's right to assert a lien in the event of non-payment by the operator.

⁷² La. Rev. Stat. Ann. 23:1061(A)(3).

⁷³ The provision is also beneficial to contractors because to the extent the operator is protected by the statutory employer provision, the contractor will not have significant liability under its indemnity obligation; consequently, the contractor should not object to this provision because any contractor that owes the operator indemnity for claims by the contractor's employees will benefit if its employee can not sue the operator in tort. La. R.S. 23:1061(A)(3).

⁷⁴ The turnkey and footage contracts do contain such "claims and liens" provisions.

5. Indemnity for Gross/Sole Negligence or Breach of Warranty

Many operators believe that they should not be obligated to indemnify the contractor if the contractor breaches its contractual warranties and obligations and a casualty results.⁷⁵ Neither should the contractor be entitled to indemnity where a loss results from the contractor's gross or, in some instances, sole negligence. To do so in either case, they agree, would reward a contractor for action or inaction that should be discouraged. Operators may consider adding a provision to the drilling contract to meet these goals. No doubt, however, the contractors will resist these types of modifications, at least to some extent.

In many instances, the contractor will argue that it cannot lose indemnity for every innocuous breach a contract, *e.g.*, when a tool was inspected/tested one day later than recommended. While this is a reasonable objection, the concern can be mitigated by drafting the provision to take effect only upon the contractor's *material* breach of specified safety regulations or other critical warranties or obligations. The operator is still likely to get significant "push back" from the contractor on any such attempted modification.

The contractor's objection to a sole/gross negligence exception for indemnity protection may be similar; whether a party was "grossly" negligent will be argued to be a subjective standard. The courts seem to be cracking down on specious attempts to classify routine negligence as "gross,"⁷⁶ but the contractors will still be concerned about uneven application of gross negligence standards. In certain circumstances, however, a sole negligence or gross negligence exception is worth considering and can be negotiated, particularly in areas in which the indemnity owed by the operator is a "carve-out" from the basic reciprocal indemnity provisions.

V. Specific Pitfalls of IADC Forms

Most drilling contractors would admit that IADC forms favor the drilling contractor. With any standardized form that favors one party (the contractor in this instance), it is harder for the other party (the operator) to deviate from the form. This fact emphasizes the importance of starting negotiations with an acceptable form – sometimes referred to in the industry as "the battle of the forms." That is not always possible, however. Consequently, it is important to know some of the major pitfalls under the IADC forms as well as some possible modifications. We start with the April 2003 daywork form, as that form and its 1998 predecessor are the most

⁷⁵ *Olympic Ins. Co. v. H.D. Harrison, Inc.*, 463 F.2d 1049 (5th Cir. 1972), *cert. denied*, 410 U.S. 930 (1973) (party that breaches a contract cannot insist on bilateral performance from the other party).

⁷⁶ *See, e.g., Houston Exploration Co. v. Halliburton Energy Services, Inc.*, 269 F.3d 528, 532 (5th Cir. 2001) (reversing district court's determination that worker's failure to verify that the valve he installed had been properly set amounted to gross negligence).

commonly used forms in the market, especially when the demand for drilling is high as compared to the availability of rigs.⁷⁷

A. Daywork

The threshold issue with the IADC daywork form is that the drilling contractor attempts to accept only those obligations expressly set forth and attempts to minimize its obligations, control, and responsibility. This results to some extent from a perennial difference in perspective between operators and drilling contractors.

1. Preamble

The preamble, by defining “daywork basis” as being under the “direction, supervision and control” of the operator, implies a relationship that some would argue does not – and should not – exist. The contractor may follow a drilling program designed by the operator’s engineer, but the specific drilling methods (speed of making hole, when to trip, mud weight, etc.) are left to the contractor. The drilling contractor, after all, is an expert in performing drilling operations; the contractor performs “as requested” by operator but the details of how the drilling is performed are not controlled or directed by the operator, and the contractor remains an independent contractor. Thus, operators may consider deleting any language overstating the operator’s control of the drilling operations.

Even more importantly, the preamble purports to limit the contractor’s obligations and liabilities to those the contractor has “specifically assumed,” leaving the balance of any potential liabilities as “liabilities assumed by” the operator. This approach creates significant uncertainty and opens up broad potential liability to the operator for any risks that are left unallocated in the contract, such as claims by true third parties. The issue is highlighted by the provision of paragraph 14.13 which states that all “liabilities assumed” by the parties throughout the contract (*i.e.*, including the preamble) apply regardless of the sole or concurrent negligence of the indemnitee. This floating “magic language”⁷⁸ in Paragraph 14.13 should be limited to the indemnity provisions in Paragraph 14, and the liability allocation provisions in the preamble should be deleted as well. In other words, the best approach is to delete potentially confusing language in the preamble, let Paragraph 14 control the parties’ rights and responsibilities with respect to risk allocation, and make sure that the floating “magic language” in Paragraph 14.13 applies only to the extent intended by the parties.

Finally, the preamble states that the contractor will be paid “fully” at the applicable rates in the contract. Obviously, the contractor is entitled to be paid the rate it negotiated. But the use of the “fully” seems to imply that the contractor will be entitled to a certain amount, regardless of its performance or a contrary provision in the contract. If possible, the word “fully” should be deleted; it either is not necessary or it means more than the operator may be willing to accept.

⁷⁷ Anderson, *supra* note 2, at 376; *IADC Prepares the Latest in Drilling Contract Forms*, DRILLING CONTRACTOR, September/October 2003, p. 20.

⁷⁸ *Ethyl Corp. v. Daniel Const. Co.*, 725 S.W. 2d 705 (Tex. 1987).

2. Drilling Fluid Rates (Subparagraph 4.7)

The 2003 form includes a new provision, Subparagraph 4.7, entitled “Drilling Fluid Rates,” which provides for increased fees when so-called “exotic” or oil-based drilling fluids, or potassium chloride are used in the operations. The increased fee is based on the additional time for rig clean up and for damage to clothing.⁷⁹ The fee is usually nominal, and it should not be a huge concern to the operator, unless the contractor inserts significant figures in Subparagraph 4.7(a), (b), and (c). But where Subparagraph 4.7 is implicated, to be careful, the operator should insert that only “reasonable” rig cleaning costs may be charged.

3. Force Majeure Rate (Subparagraph 4.8)

The force majeure rate (Subparagraph 4.8) will generally be the same as the operating rate, or only slightly less. Therefore, the most important issue with respect to 4.8 is that the operator must have a way out of the contract if the force majeure event lasts for an extended period of time. Without a cap on the force majeure rate, such an event could conceivably last for months, costing the operator hundreds of thousands of dollars.⁸⁰

The IADC form provides that operator retains its “right to direct stoppage of the work,” but that right only applies once the rig can leave the location. Consequently, the operator must confirm that application of the early termination provisions will be acceptable in the event of a force majeure and should also provide for an absolute right to terminate the contract, or cease payment, after a certain period of time. In addition, if the provision is modified to allow either party to terminate, the operator should reserve the right to keep the contract in effect, in its sole discretion, if it is willing to pay the force majeure rate.⁸¹

4. Reimbursable Costs (Subparagraph 4.9)

Subparagraph 4.9 (Reimbursable Costs) requires the operator to reimburse the contractor for the cost of materials, equipment, worker’s services which are to be furnished by Operator as provided for herein, but which for convenience or actually furnished by contractor at operator’s request, plus a handling charge. So far, so good. But Subparagraph 4.9 also deems such services or items as operator-furnished items or services for purposes of the indemnity and release provisions of the contract. Moreover, any subcontractor so hired is “deemed to be Operator’s contractor, and Operator shall not be relieved of any of its liabilities in connection therewith.”

The operator may consider reversing this arrangement, so that anything furnished by contractor becomes a contractor-furnished item; otherwise, the operator will owe indemnity for

⁷⁹ DRILLING CONTRACTOR, *supra* note 76, at p. 20.

⁸⁰ The authors are aware of one instance in which the repairs to the drilling rig as a result of damage sustained while moving on location were anticipated to take months. At the prevailing standby rate, the potential exposure for downtime was enormous. Fortunately, that contract had been modified to at least put a thirty-day cap on payment for downtime, but the cost was nevertheless substantial.

⁸¹ That concern might only arise if there the operator is facing a lease termination issue.

subcontractors that have been hired by the drilling contractor, under the drilling contractor's contract, and the operator will have no idea whether that contract provides the operator with the appropriate contractual protection. At a minimum, such contract is unlikely to extend the subcontractor's indemnity obligations to the operator's other contractors, and as discussed in Section IV(A) of this paper, that can be a very significant issue depending on the provisions of the operator's other contracts.

5. Disputed Invoices and Late Payment (Subparagraph 5.2)

Invoice disputes are a common occurrence in any almost any service or production business. But how the parties prepare for them can determine whether business relationships are ruined, a project is delayed, or lawsuits are filed. A serious problem arises when the contractor demands immediate payment of a certain sum, and threatens to pull the rig if an immediate and unqualified payment is not made. Subparagraph 5.2 (Disputed Invoices and Late Payment) now allows the contractor to either terminate the contract or suspend operations until payment of an *undisputed* amount is made. It does not, however, provide for the contractor's right to terminate the contract or suspend operations where the operator stands ready to pay the undisputed portion of an invoice. Nevertheless, the authors are aware of several instances in which this happened anyway. In that situation, the operator's dilemma is whether to pay (and possibly be deemed a "volunteer" and lose the right to recoup the funds later)⁸² or to call the contractor's bluff and refuse to pay (perhaps losing the well in the process).

The best approach is to plan for potential disputes and add language to Subparagraph 5.2 allowing the operator to pay even disputed invoices, subject to its right to later contest the accuracy of the invoice. This modification provides two benefits to the operator. First, it removes any leverage the contractor has over the operator while the hole is open, and it lets the operator "give in" temporarily to keep the project moving. Second, it can give the operator more time to review questionable invoices and to either confirm their propriety or work out a compromise. This revision is usually accepted by contractors without complaint.

6. Sound Location (Paragraph 10)

The sound location provision, found at Paragraph 10, is fraught with potential danger for the operator, especially because the drilling rig is an expensive item (which may be uninsured for the operator) and the ingress to the drilling site creates significant opportunity for a casualty.⁸³ Paragraph 10 states:

Operator shall prepare a sound location, adequate in size and capable of properly supporting the drilling rig, and shall be

⁸² See, e.g., *Mobile Telecommunication Technologies Corp. v. Aetna Cas. & Sur. Co.*, 962 F. Supp. 952 (S.D. Miss. 1997).

⁸³ *Miller Exploration Co. v. Energy Drilling Co.*, 130 F.Supp.2d 781 (W.D. La. 2001), *aff'd*, 2002 WL 243257 (5th Cir., Jan 16, 2002) (operator's liability for damage to the rig under Paragraph 10 is not limited to situations in which the operator must warn the contractor of a condition or select a different site).

responsible for a casing and cementing program adequate to prevent soil and subsoil wash out. It is recognized that operator has superior knowledge of the location and access routes to the location, and must advise Contractor of any subsurface conditions, or obstructions (including, but not limited to, mines, caverns, sink holes, streams, pipelines, power lines, and communication lines) which Contractor might encounter while en route to the location or during operations hereunder. In the event subsurface conditions cause a cratering or shifting of the location surface, or if sea bed conditions prove unsatisfactory to properly support the rig during marine operations hereunder, and loss or damage to the rig or its associated equipment results therefrom, operator shall, without regard to other provisions of this Contract, including Subparagraph 14.1 hereof, reimburse Contractor for all such loss or damage, including removal of debris and payment of Force Majeure Rate during repair and/or demobilization, if applicable.

There are several problems with this provision from the operator's standpoint. First, Paragraph 10 as drafted in the form contract assumes the operator's superior knowledge of the drill site, which may or may not be the case. Second, it is a "carve-out" that places liability for damage to the drilling rig on the operator even though contractor has insurance, and the operator may not. Third, payment (including debris removal) of the force majeure rate during repairs can be a very significant exposure depending on how long repairs take, and such payment could be considered the equivalent of consequential damages to contractor during the repairs. Finally, and more significantly, the floating "magic language" of Subparagraph 14.13 applies to Paragraph 10, which means that operator owes all of the above obligations even if the casualty has been caused by the sole or concurrent negligence (or even gross negligence under Subparagraph 14.13) of the contractor or its subcontractors. Under that interpretation, the contractor could forget about an operator's warnings or recommendations about a certain location, or mistakenly fail to follow operator's warnings, and still collect the full amount of the damage to its rig and be paid force majeure rate during repairs, no matter how long. In fact, an operator has been held liable under the IADC offshore equivalent of Paragraph 10 even though the contractor was aware of the particular obstruction it hit.⁸⁴

Based on the above concerns, Paragraph 10 should be modified to reflect that the operator "may have" superior knowledge of the drill site, and has a duty to advise the contractor of "known" subsurface conditions that may damage the rig. In addition, operator's liability under Paragraph 10 for damage to the drilling rig should, at a minimum, be capped at a specified dollar amount or contractor's deductible,⁸⁵ and the exposure for the force majeure rate should

⁸⁴ See *Louisiana Land and Exploration Co. v. Offshore Tugs*, 23 F.3d 967 (5th Cir. 1994) (holding that operator was liable for damages arising out of an allision between the contractor's rig and the operator's wellhead).

⁸⁵ The operator must review this portion of the contract with its insurance broker to determine the extent of coverage for this risk.

also be capped at a specific time limit. Most importantly, the “floating magic language” provision in Subparagraph 14.13 should be limited to the provisions of Paragraph 14 so that the operator is not liable for the contractor’s negligence.

7. Termination of Location Liability (Paragraph 12)

Paragraph 12, entitled “Termination of Location Liability,” is significantly different from the July 1998 daywork form contract. Whereas under the 1998 version, the operator assumed liability for damage to property and bodily injuries as a result of conditions at the location only after “contractor has complied with all obligations of the Contract regarding restoration of Operator’s location,” the new version is more restrictive. Under the April 2003 daywork contract, liability for conditions at the drill site falls to the operator after the contractor “has concluded operations at the well location.” However, even contracts using the 1998 daywork form contained no express obligations regarding “restoration of the drill site,”⁸⁶ so the point was probably moot. Nevertheless, the contractor should be required to leave the site in a safe condition, free from large holes, trash, uncovered pits, etc. The best way to accomplish this is to revert to the 1998 language and make the operator’s acceptance of site liability subject to the contractor’s complying with “Operator’s reasonable requests regarding restoration of the site.” Even better for the operator would be to delete this provision and let the risk allocations provisions remain in place.

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8. Insurance (Paragraph 13)

The insurance provisions in the 2003 daywork form are found at Paragraph 13 of the base contract and Paragraph 3 of Exhibit “A.” The basic requirements are already in the contract, but some modification is required to maximize protection. For example, there is no requirement in the form that the contractor’s insurance is primary, nor is there an extension of insurance protection to Operator Group.⁸⁶ These provisions should be modified as discussed in Section IV(B) of this paper to avoid unintended consequences.

9. Responsibility For Loss Or Damage, Indemnity, Release of Liability, and Allocation of Risk (Paragraph 14)

The daywork contract’s indemnification and risk allocation provisions are contained in Paragraph 14. Generally, each party takes responsibility for its own people, property, some pollution risks, and consequential damages, regardless of fault.⁸⁷ There are “carve outs” or exceptions to the general rule, which result from industry custom. The operator is responsible for the contractor’s downhole tools, damage to contractor’s surface equipment damaged by corrosive elements,⁸⁸ well control, the hole, and underground damage.

Deleted: environmental,

⁸⁶ Please refer to the discussion of pass-through indemnity protection in Section IV(A) of this paper.

⁸⁷ As explained in Section IV(A) of this paper, indemnity provisions for personal injury may not be enforceable under certain anti-indemnity acts without modification.

⁸⁸ *Miller Exploration Co. v. Energy Drilling Co.*, 130 F.Supp.2d 781 (W.D. La. 2001), *aff’d*, 2002 WL 243257 (5th Cir., Jan 16, 2002) (rejecting operator’s argument that it was not responsible for

Responsibility for pollution is allocated somewhat differently. Under Subparagraph 14.11, the contractor is responsible for pollution and contamination that originates above the surface of the land or water and which is “wholly in Contractor’s possession and control and directly associated with Contractor’s equipment and facilities.” The operator, on the hand, takes responsibility for any other pollution, including events that result from blowouts, and further including the disposition of drilling fluids. The operator’s indemnity now includes the contractor’s suppliers, contractors and subcontractors of any tier. Subparagraph 14.11(c) makes each party liable for the pollution events caused by its subcontractors.

The pollution indemnity scheme is not generous to the operator. And although most contractor’s will be reluctant to compromise, the operator may endeavor to strengthen the language of the contractor’s indemnity obligation, to delete or modify the reference to that which is “wholly in Contractor’s possession and control and directly associated with Contractor’s equipment and facilities.” Note also that the contractor’s pollution obligation becomes very limited with a string of conjunctive “ands,” which decreases the likelihood of the contractor’s being tagged for a pollution liability. Perhaps the “ands” should be replaced in each instance with “or” to balance the pollution risk allocation. The operator might consider also limiting operator’s pollution obligation to control, removal, and cleanup, instead of the all claims language in the contract.

In the absence of modification, the release, defense, and indemnity obligations extend to the operator’s affiliated entities, partners, employees, etc., but not the operator’s other contractors, which can be a very significant issue. Thus, it is important to modify Subparagraph 14.13 to obtain pass-through coverage.

It is extremely import to note that the magic language in Subparagraph 14.13 extends to Subparagraphs 4.9 (Reimbursable Costs) and 6.3(c) (Early Termination by Contractor), Paragraphs 10 (Sound Location) and 12 (Termination of Location Liability). Operators are encouraged to strike references to all of these other provisions, inasmuch as many of the risks they include are not properly the subject of risk allocation regardless of fault.

10. Consequential Damages (Subparagraph 14.2)

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Subparagraph 14.2 (Consequential Damages) in the 2003 form is an extension of the mutual consequential damages waiver in the 1998 version. The first difference is that “consequential damages” includes the cost of or loss of use of property, equipment, materials and services, including, without limitation, those provided by contractors or subcontractors of every tier or by third parties. The current version also requires the operator to:

indemnify contractor and its suppliers, contractors and subcontractors of any tier, from and against all claims, demands and causes of action of every kind and character in connection with

lost drill pipe because this “down hole equipment” was not actually inside the hole when destroyed).

such special, indirect or consequential damages suffered by operators, co-owners, co-venturers, co-lessees, farmers, farmees, partners and joint owners.

The problem with this obligation as respects the operator's other contractors and subcontractors is that operator's contracts with them may contain a waiver that only covers the operator, not other parties, like the drilling contractor. In addition, a waiver is different from an indemnity provision and would presumably not include a defense obligation. In other words, the operator may be taking on significant unprotected risk if it gives protection to the drilling contractor that it cannot "pass through" from its other contractors.

11. Audits (Paragraph 15)

Paragraph 15 requires the contractor to make its books and records available for two years for audits. Many joint operating agreements, however, have provisions allowing non-operators to audit books for three years. This means that the two-year period may be insufficient. Therefore, the audit period should be extended if possible.

12. Information Confidential (Paragraph 19)

The daywork form requires the contractor to keep confidential information regarding coring, surveys, logs, etc., but only "upon written request by Operator." There is no reason why the burden should be on the operator to ask for obviously confidential information to be kept confidential.⁸⁹ The quoted language should be deleted.

13. Governing Law (Paragraph 18)

Although state law conflicts of laws rules may direct the application of the law where the drill site is located, it is prudent to specify what law will govern disputes arising out of the contract. To avoid an unexpected result, *e.g.*, the application of *renvoi* (in which the conflicts rules of the chosen jurisdiction direct the application of another jurisdiction's laws),⁹⁰ the governing law provision should be modified to specify that the chosen law "excludes any conflicts of laws rules that would direct the application of another state's substantive law."

14. Subcontracting (Paragraph 20)

Paragraph 20, modified from the 1998 form, now allows for the contractor to subcontract any of the operations or services to be provided. This operator should consider whether to amend this provision to require approval by the operator of the selected contractors and/or subcontractors in case the contractor selects a subcontractor to which the operator has reasonable objection.

⁸⁹ Ottinger, *supra* note 24, at 151.

⁹⁰ *Arochem Corp. v. Wilomi, Inc.*, 962 F.2d 496, 498 n. 3 (5th Cir. 1992); *American Motorists Ins. Co. v. Artra Group, Inc.*, 659 A.2d 1295, 1301 (Md. 1995); RESTATEMENT (SECOND) CONFLICTS OF LAWS § 8 (1971).

15. Attorney fees (Paragraph 21)

The attorney fee provision is reciprocal, so it is a double-edged sword. The operator should consider whether it wants to delete this provision.

16. Warranty of Contractor's Standard of Performance

A drilling contract should address the standard of performance required of the drilling contractor.⁹¹ But the daywork form has no requirement for the contractor to perform its duties to a certain standard. And while the law may provide for an implied warranty of performance,⁹² it is reasonable to require the contractor to "warrant" that it will perform its duties with due diligence, in a good and workmanlike manner to a certain standard and with a trained crew.⁹³ A contractor may, however, resist the use of the term "warranty" (which admittedly contains some implications likely to make the driller's contracts manager uncomfortable). A suitable compromise is to substitute the word "represents," which still creates a contractual obligation for the contractor to perform to in a workmanlike manner.⁹⁴

B. Turnkey

The most important task for the operator using a turnkey form is to specify the exact nature of the contractor's turnkey obligation (for example, the required condition of the hole and whether a log is required), the procedure and basis for switching between turnkey operations and daywork operations, the procedure, grounds, and consequences in the event the operator wants to terminate the contract as a result of poor performance by contractor, the criteria for optional turnkey operations (like a plug and abandonment), and the extent to which the contractor has the discretion to modify the well program (which can result in savings to the contractor at the expense of the operator's objectives).⁹⁵

1. Preamble

⁹¹ Anderson, *supra* note 2, at 409.

⁹² *Fontenot v. Mesa Petroleum Co.*, 791 F.2d 1202 (5th Cir. 1986); *Ruby Drilling Co., Inc. v. Duncan Oil Co., Inc.*, 47 P.3d 964, 967 (Wyo. 2002) (relying in part on contractor's duty to perform in a workmanlike manner to hold that the drilling contractor was not entitled to damages for completing a well on a footage basis where the well took much longer than expected and was not straight).

⁹³ *See W.E. Meyers Drilling Corp. v. Elliott*, 695 S.W.2d 809, 811 (Tex. Civ. App.—El Paso, 1985), where the court held that the contractor was required to obtain a jury finding that it drilled the well with due diligence under a daywork contract in order to establish substantial performance. The "due diligence" clause put some limit on the operator's obligation to pay for excessive delays. Thus, the contractor recovered for the number of days reasonable and necessary to complete the well, but not for additional delays.

⁹⁴ Ottinger, *supra* note 24, at 138-39

⁹⁵ *Id.* at 115-17.

The turnkey preamble is similar to the daywork form's language, although it takes into consideration the nature of the turnkey contract. Thus, many of the same changes should be made. Additionally, for reasons explained below, the operator should consider revising the preamble to specify that the conditions of Paragraph 10 must be fulfilled completely before the turnkey price is earned.

2. Turnkey Depth (Subparagraph 3.1)

The turnkey depth is the primary requirement for earning the turnkey price, and its calculation is straightforward. An exception is where the parties agree to use stratigraphic equivalents. Stratigraphic equivalents can create problems due to their ambiguity. The problems are less serious if the well being drilled is for development purposes in an established field, if there is no way to eliminate risk as long as an equivalent is used. There are several ways to minimize the risk. First, the stratigraphic equivalent can be tied to a particular well log, by date, by well serial number, and either by format (*e.g.*, 1" log or 5" log). This will at least eliminate any argument about what the marker is for the depth in that area. Additionally, the contract can establish that the stratigraphic equivalent can be no less than a certain depth, regardless of the stratigraphic equivalent depth. Finally, the operator should try to leave itself in control of whether the stratigraphic equivalent will be the measure of correct depth, so portion of the contract can be modified to be triggered "in the opinion of the operator." Of course, if possible the stratigraphic equivalent clause should be deleted. If the geology of the area is fairly well-established, then there is no strong reason why the contractor would want to have the clause anyway.

3. Daywork Basis Drilling (Subparagraph 3.2)

In its original form, Subparagraph 3.2 reads as follows:

All drilling below Turnkey Depth and all work performed which is not specified to be performed by Contractor on a Turnkey Basis shall be performed on a Daywork Basis as defined herein, and Contractor shall be paid for such drilling and work at the applicable Daywork Rate specified in Paragraph 4.

Simply put, anything that is not turnkey is daywork. That might sound clear at first blush, but the language has created confusion in past operations with which the authors are familiar. In each case, the contractor honestly thought that the work was on a daywork basis when the operator thought just the opposite.

Subparagraph 3.2 should be modified to emphasize that the operations do not turn to a daywork basis until the contractor's "turnkey commitment" under Paragraph 10 has been "completely fulfilled" and the well has been accepted by the operator under Paragraph 10. Additionally, the structure of Subparagraph 3.2 – that anything that is not turnkey is daywork – should be flipped such that except as provided in Subparagraph 4.7, no other work shall be on a daywork basis unless the contractor is specifically instructed in writing to perform work beyond that which is contained in the turnkey commitment.

4. Contract Depth (Subparagraph 3.3)

The clause in subparagraph 3.3(a) does not seem to have any real meaning for the contract, and it should be deleted. As for subparagraph 3.3(b), there is nothing *per se* wrong with specifying a maximum depth for the operation, but the maximum number should be generous enough to allow for unexpected anomalies in the geography. Otherwise, the operator cannot force the contractor to drill beyond this depth, even on a daywork basis.

5. Turnkey Amount (Subparagraph 4.1)

The turnkey amount, of course, is a commercial matter to be negotiated between the parties and will depend on market conditions at the time the contract is negotiated (including the availability of rigs and the tempo of drilling activity in the area), as well as the nature of the well to be drilled, the geography in the area, and the expected depth of the well. Nevertheless, it is extremely important to specify that where the well was to be plugged and abandoned, that payment is due only upon the turnkey depth being reached and the requirements of Paragraph 10 are completely fulfilled.

6. Daywork Operations (Subparagraph 4.7)

Subparagraph 4.7 describes the various circumstances under which the contract will revert to a daywork basis. There are two significant modifications to the daywork operations clauses operators should consider. First, Subparagraph 4.7(a) should be deleted and language inserted that makes the standard reversion to daywork basis contingent upon the contract to complying with its turnkey obligations in Paragraph 10, including the well's being accepted by the operator. Any additional turnkey operations can be excepted from this provision. Secondly, an additional subparagraph should be added to obligate the contractor to notify the operator in writing any time a contractor thinks that it is or shortly will be operating on a daywork basis, and that the contractor will not be able to claim payment on a daywork basis unless it does so. This gives the operator a reasonable time to evaluate the well and decide what further operations should be conducted.

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7. Time for Payment (Subparagraph 5.1)

As with other provisions regarding the contractor's obligations, payment on a turnkey basis should be contingent upon the contractor's completely fulfilling its Paragraph 10 obligations.

8. Early Termination Compensation (Subparagraph 6.3)

Care should be taken with respect to early termination compensation to ensure that the formula used does not encourage the contractor to set the casing too early. The operator's liability for termination of a particular depth must be proportionate to the depth actually reached. The operator should note that if the contractor threatens to leave the job based on an early termination provision (whether real or perceived) or claims force majeure, the operator could be left facing nearly the entire cost of the well without having reached its objective.

9. Casing Program (Paragraph 7)

Paragraph 7 essentially directs the parties to Exhibit "A" to determine the size of the hole, the procedure for setting the casing, and to establish that setting the casing below the turnkey depth is performed on a daywork basis. Unaltered, Subparagraph 7.4 appears to give the contractor the power to modify the casing program without the operator's consent:

Operator or contractor may modify said casing program provided any modifications thereof which materially increase Contractor's hazards or costs of performing its obligations hereunder can only be made by mutual written consent of Contractor and Operator. In such event Contractor agrees to run casing, cement and test cement on such lineage and strings of casing and to perform cement squeezing jobs as required by Operator. Operator shall furnish all necessary materials and services and all such work shall be on a Daywork Basis.

The word "contractor" should be deleted from the beginning of Subparagraph 7.4, thus eliminating the contractor's right to change the program. Alternatively, the contractor's right to modify the program should be limited by its obligation to provide a hole size at turnkey depth no smaller than that which is specified in Exhibit "A," and that any redesign of the well program is subject to the operator's written consent. This is a reasonable modification, and it would not ordinarily be subject to a strong objection by the drilling contractor.

10. Turnkey Commitments and Liability (Paragraph 10)

It should be obvious from the above discussion that Paragraph 10 is beyond doubt the most important provision in the turnkey contract form. In its original state, Paragraph 10 provides as follows:

10.1 Upon completion by Contractor of all operations to be performed by it under the Turnkey Basis as specified in Exhibit "A", Paragraph 10, Contractor shall notify Operator of such completion by noting the date and hour of such completion upon the daily drilling report form required by Subparagraph 12.1 hereof. No later than twenty-four (24) hours after Operator's receipt of such notification, Operator shall advise Contractor in writing of any objections it may have with respect to Contractor's performance hereunder. Operator's failure to so object to Contractor's performance within the specified period shall be conclusive proof of Operator's acceptance of the well and Contractor's performance hereunder.

10.2 Upon acceptance of the work by Operator pursuant to Subparagraph 10.1 hereinabove, all risk of loss with respect to the well drilled hereunder and goods and services provided by

Contractor shall pass to Operator. Contractor shall have no liability for any defects in such completed operations. Notwithstanding anything else contained herein to the contrary, Operator accepts all material, supplies, equipment and services furnished or performed by Contractor as is and where is. CONTRACTOR MAKES NO WARRANTY, EXPRESSED OR IMPLIED, AS TO THE MERCHANTABILITY, OR FITNESS OF ANY MATERIALS, SUPPLIES OR EQUIPMENT FOR ANY PURPOSE. NO WARRANTY OF GOOD AND WORKMANLIKE PERFORMANCE IS GIVEN BY THE CONTRACTOR BY VIRTUE OF THIS CONTRACT FOR ANY PERFORMANCE ACCEPTED BY OPERATOR.

It may be difficult to simply modify Paragraph 10 to include all of the details necessary to protect the operator and both parties against the uncertainty created by the original text. The operator should consider striking Subparagraph 10.1 and replacing it with a new provision that specifies that the contractor must complete all of its obligations prior to the operator incurring any liability for well acceptance or for payment of the turnkey price.⁹⁶

These obligations should include: (a) the well drilled to the turnkey depth; (b) the well being drilled in accordance with specifications of Paragraph 4 of Exhibit A; (c) the hole size at all depths must meet or exceed the requirements set out in Exhibit A; (d) the well is turned over to the operator's safe controlled condition in compliance with all applicable laws and regulations and must remain so during the evaluation period provided for in Subparagraph 10.2; (e) the well must have no annulus pressure at the surface; and (f) all logs required must have been run successfully with useable results printed in standard format and delivered to the operator. Finally, the contract should specify that the contractor's failure to provide one hundred percent compliance with the above criteria will release the operator from its liability for any well.⁹⁷

Subparagraph 10.2 describes the trigger for risk of loss with respect to the well to the operator, and provides that "contractor shall have no liability for any defects in such completed operations," and that "the operator accepts all material, supplies, equipment and services furnished or performed as is where is," without any warranty. By itself, there is nothing wrong with this provision inasmuch as it is based upon the contractor's compliance with its Subparagraph 10.1 obligations. The contractor should be required to provide written notice to the operator when the contractor believes that it has met the requirements of Subparagraph 10.1 to give the operator time to evaluate the well and to determine whether in fact the contract

⁹⁶ As a practical matter, if the operator is starting off with the IADC form (rather than its own specially tailored form), it is already at a disadvantage. But to minimize the contractor's resistance to important changes to the IADC form, it is normally better to try to *work with the form*, and modify the existing text with strikethroughs and additions, rather than to delete whole paragraphs from the contract.

⁹⁷ Ottinger, *supra* note 24, at 125 (the general rule of substantial compliance has no application in the context of a turnkey contract).

obligations have been satisfied and whether there will be any optional turnkey operations. The provision should be added to establish that the well remains on a turnkey basis, with the risk of loss on the contractor during this evaluation time, and must still be turned over to the operator for the contractor to be entitled to a turnkey price.

11. Sharing of Information

At this point in the contract it is appropriate to insert provisions establishing the basis on which information will be shared between the parties. A new provision should indicate that the operator and contractor agree that it is in their mutual interest to share information. This clause should, however, make it clear that due to the nature of the turnkey form, the contractor is not obligated to follow any of the operator's suggestions. It should also be made clear that any observations or information provided by the operator will not be deemed to convert the operations from a turnkey basis to a daywork basis. Finally, an important modification in the context of a turnkey contract is to have some sort of waiver or non-warranty provision to establish any information that the operator provides to the contractor about the well site or geographical conditions are correct to the operator's belief, but the operator is not making any representation or warranty as to the correctness of that information. The provision should emphasize that the contractor is making its own independent determination concerning all of the conditions that can be encountered during the drilling process, including the formations at the drill site or any other condition that might affect the planning or drilling of the well.

12. Coring, Drill Stem Test, and Wire Logging (Subparagraph 11.4)

Subparagraph 11.4 states that the operator shall have a period of time to determine whether a string of casing or liner is to be run or the well is to be plugged and abandoned. This provision should be deleted, inasmuch as the subject matter is already covered in Subparagraphs 4.7 and 10.2. Also, as it is written, it does not give the operator time to consider whether to accept the well, reject the well, set pipe, or plug and abandon. If the operator is unsuccessful in deleting Subparagraph 11.4, some language should be added to emphasize that the risk of well loss remains on the contractor during the evaluation period.

13. Equipment Capacity (Paragraph 15)

This is a new provision in the turnkey form, which probably benefits both parties from a safety standpoint and which seems to reinforce the notion of the contractor as being a "independent contractor." Paragraph 15 reads:

Operations shall not be attempted under any conditions which exceed the capacity of the equipment specified to be used hereunder or where canal or water depths are in excess of ____'. Without prejudice to the provisions of Paragraph 18 hereunder, Contractor shall have the right to make the final decision as to when an operation or attempted operation would exceed the capacity of specified equipment.

Note that Paragraph 15 is apparently subordinate to the risk allocation scheme contained in Paragraph 18, which could make for some interesting situations if a casualty results from the driller's pushing its equipment too hard.

14. Insurance (Paragraph 16)

The insurance considerations described in Section IV(B) of this paper apply here. The operator, however, should consider deleting references to the contractor's self-insurance program, which raises questions of the contractor's solvency and makes for somewhat complicated issues for establishing the contractor's solvency and ability to meet any insurance obligations it has under the contract. Additionally, the operator should delete the words "insuring a liability specifically assumed by Contractor under Paragraph 17 of this Contract." The contractor limits its insurance obligations "to extent of the indemnity obligations assumed herein." But limiting the contractor's insurance obligations to those liabilities described in Paragraph 16 is arguably too narrow.

15. Responsibility for Loss or Damage, Indemnity, Release of Liability and Allocation of Risk (Paragraph 18)

The same considerations described in Sections IV(A) and IV(B) of this paper apply here. Essentially, nearly all well-related risk is retained by the contractor, except when on a daywork basis, when the reverse is true. Subparagraphs 18.8, 18.9 and 18.10 include an indemnity by the operator against claims by any non-operators. But the non-operators will not be bound by the contractual limitations or damages. Consequently, if there is a blowout, a non operator might sue the contractor for loss production, and the contractor would naturally seek indemnity from the operator. The operator should ensure that in the JOA, any indemnity obligation to the contractor for damage to the hole or the formation can be passed back on to the non-operators, or alternatively, that the non-operators agree not to sue the contractor unless the operator consents.

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16. Turnkey "Outs"

The operator must establish whether the depth requirement is subject to certain "outs," such as the "Gulf Coast Clause" which allows the contractor to cease operations if in its judgment, unusually difficult or hazardous conditions have been encountered, and the effect of such an "out" if available. In other words, can the contractor "walk away" and just forfeit its right to payment or are there potential additional remedies available to the operator. Turnkey outs sometimes leave the contractor with enormous discretion to determine "unusual" conditions. If the contract will be subject to an out, it should be carefully tailored.⁹⁸

C. Footage

With respect to risk, the footage contract lies somewhere between the turnkey and daywork contracts. No doubt, the contractor takes on significant well-related risks while drilling on a footage basis. But the footage contract is different in that, in its unaltered state, the

⁹⁸ Ottinger, *supra* note 24, at 116-17.

provisions of Paragraph 12 allow for the contract to change automatically to a daywork basis, with significant consequences to payment and liability.

The 2003 footage form has many provisions in common with the daywork and turnkey forms, and several of the new changes seen in the 2003 footage contract are the same as those found in the other forms. Thus, the operator may wish to consider requesting similar modifications as described *supra*, including the preamble and those provisions addressing drilling fluid rates, reimbursable costs, disputed invoices, insurance and indemnity, and consequential damages.

1. Contract Footage Depth (Subparagraph 3.1)

Subparagraph 3.1 provides:

The well shall be drilled to feet or formation, or to the depth at which the inch casing (oil string) or liner is set, whichever depth is first reached, on a footage basis Footage Basis and Contractor is to be paid for such drilling at the footage rate specified below, which depth is hereinafter herein referred to as the contract footage depth. Contract Footage Depth.

To avoid any ambiguity, this provision should specify that the decision to accept a shallower depth is reserved to the operator, in its sole discretion.

2. Formations Difficult or Hazardous to Drill (Paragraph 12)

Paragraph 12 is probably the most critical provision in the contract, inasmuch as it controls (along with the pertinent provisions of Exhibit "A") the circumstances under which the contract will change from a footage basis to a daywork basis.

12.1 In the event chert, pyrite, quartzite, granite, igneous rock or other impenetrable substance is encountered while drilling on the Footage Basis and the footage drilled during each twenty-four (24) hour period multiplied by the footage rate does not equal the applicable Daywork rate plus cost of bits, all drilling operations shall be conducted on a Daywork Basis, with Operator furnishing the bits, until normal drilling operations and procedures can be resumed. The footage drilled on a Daywork Basis shall be deducted from the Contract Footage Depth for invoicing of footage charges.

12.2 In the event water flow, domal, steeply dipping or faulted formation, abnormal pressure, underground mine or cavern, heaving formation, salt or other condition is encountered which makes drilling abnormally difficult or hazardous, causes sticking of drill pipe or casing, or other difficulty which precludes drilling ahead under reasonably normal procedures, Contractor shall, in all such cases, without undue

delay, exert every reasonable effort to overcome such difficulty. When such condition is encountered, further operations shall be conducted on a Daywork Basis until such conditions have been overcome and normal drilling operations can be resumed. Operator shall assume the risk of loss of or damage to the hole and to Contractor's equipment in the hole from the time such condition is encountered. The footage drilled while on Daywork Basis shall be deducted from the Contract Footage Depth for invoicing of footage charges.

12.3 In the event loss of circulation or partial loss of circulation is encountered, Contractor shall, without undue delay, exert every reasonable effort to overcome such difficulty. When such condition is encountered, Operator shall assume a risk of loss of or damage to the hole and to Contractor's equipment in the hole. Should such condition persist in spite of Contractor's efforts to overcome it, then after a period of ____ hours time consumed in such efforts, further operations shall be conducted on a Daywork Basis until such condition has been overcome and normal Footage Basis drilling operations can be resumed. The total rig time furnished by Contractor on a Footage Basis under the terms of this Subparagraph shall be limited to a cumulative ____ hours. The footage drilled while on Daywork Basis shall be deducted from the Contract Footage Depth for invoicing of footage charges.

As stated above, because responsibility for numerous well-related risks as well as payment mechanisms change significantly when the Contractor begins work on a Daywork Basis, Paragraph 12 must be scrutinized to ensure that (i) the specific conditions under which "abnormal" drilling operations will be determined is reasonable, and (ii) the trigger for that change is crystal clear to both parties.

Perhaps the best way to avoid confusion and any unintended result is to add a new Subparagraph 12.4, which states, essentially, that "Notwithstanding the foregoing Subparagraph 12.1, 12.2, and 12.3, a transition to a Daywork Basis shall not take place until there has been written notice to Operator's representative and agreement by Operator." This approach avoids confusion resulting from high tempo operations and the occasional lapse in good communications between the operator and contractor.⁹⁹

3. Ingress and egress to location (Paragraph 14)

⁹⁹ See, e.g., *Startex Drilling Co., Inc. v. Sohio Petroleum Co.*, 680 F.2d 412, 413 (5th Cir. 1982) (provision to change to daywork rate, which was based on diminishing mud returns, was ambiguous); *Samson Resources Co. v. Quarles Drilling Co.*, 783 P.2d 974, 978 (Okla. App. 1989) (contract did not make express provision for notice to operator of a change from footage to daywork, but court of appeals held that notice was an implied condition of the contract.); *Primrose Operating Co. v. Jones*, 102 S.W.3d 188 (Tex. Ct. App. 7th Dist – Amarillo, 2003) (in a personal injury suit, operator did not gain complete control over drilling operation when working on a daywork basis).

Paragraph 14 provides:

Operator shall reimburse Contractor for all amounts reasonably expended by Contractor for repairs and/or reinforcement of roads, bridges, and related or similar facilities (public and private) required as a direct result of a rig move pursuant to performance hereunder. If the location is furnished by Operator, Operator shall be responsible for any costs associated with leveling the rig because of location setting.

This provision, requiring the operator to provide legal and practical access to the drill site, as compared to the 1998 footage contract, is reasonable and hardly changes the party's responsibility from the 1998 version, inasmuch as most of the new text¹⁰⁰ has simply been moved from Subparagraph 4.3 of the 1998 form. Additionally, Paragraph 14 is not covered by the "floating magic language" contained within Paragraph 19.15, so this new provision should not result in too many problems for either party.

4. Responsibility for Loss (Paragraph 19)

The risk allocation scheme essentially mimics the turnkey approach while on a footage basis, and adopts the daywork approach if an when the contract converts to a daywork basis. The considerations discussed in Sections IV(A), V(A)(9), and V(B)(15) apply here.

5. Abnormal Pressure (Exhibit "A," Paragraph 2)

This paragraph is designed to be read in conjunction with Paragraph 12. "Abnormal pressure" is defined with reference to mud weight. Because this mud weight will determine a shift to a daywork basis, the operator, with the advice of its engineer, must carefully review the standard for determining abnormal pressure.

An important footage contract case is *Cleere Drilling Co. v. Dominion Exploration*.¹⁰¹ In *Cleere Drilling*, Dominion contracted with Cleere to drill a well under the 1998 IADC footage contract. Well before reaching the contract footage depth, Cleere's driller swabbed the well during a "short trip," resulting in abnormal well pressure and a loss of circulation or "mud returns." Eventually, the well blew out and could not be contained by the rig's blow out preventers. Prior to the short trip, however, the crew was drilling ahead normally. Cleere sued

¹⁰⁰ Operator agrees at all time to maintain the road and location in such a condition that will allow free access and movement to and from the drilling site in an ordinarily equipped highway-type vehicle. If Contractor is required to use bulldozers, tractors, 4-wheel drive vehicles, or any other specialized transportation equipment for the movement of necessary personnel, machinery, or equipment over access roads or on the drilling location, Operator shall furnish the same at its expense and without cost to Contractor.

¹⁰¹ 351 F.3d 642 (5th Cir. 2003).

Dominion to recover for services performed before and after the blowout, including the “value” of the hole that Cleere had drilled before it lost well control, the daywork rate for work after well control was lost, and equipment lost in the hole. Dominion counterclaimed to recover costs and expenses for controlling the blowout, cleanup and restoration of the surface location, settlement of damage claims with the landowner, and the differential between Dominion’s cost of drilling a replacement well and the well price under the contract. The district court awarded Dominion the entire amount sought and rejected all of Cleere’s claims.

The main issue on appeal was whether the drilling operation had, pursuant to Paragraph 12 of the footage contract, automatically converted from a footage basis to a daywork basis when Cleere experienced abnormal well pressure. The presence of any of these conditions would have converted the contract to daywork status and would have changed the risk allocation scheme from the footage/turnkey model to the daywork model. Under daywork, of course, Dominion (as the operator) would have been responsible for well control, payment of the daywork rate, and loss of hole/re-drill.

The Fifth Circuit agreed with the district court that if the unusual conditions (including abnormal pressure) did occur, they occurred only after Cleere’s actions that caused the blowout. The court of appeals refused to interpret Paragraph 12 to mean that Cleere could create the unusual drilling conditions (through swabbing the well), and then claim that the contract was converted to a daywork basis due to those same conditions. Thus, because Cleere was still working on a footage basis when the well blew out, it would not be entitled to payment at the daywork rate and it remained responsible for the hole, well control, re-drill, and its in-hole equipment.¹⁰²

The *Cleere Drilling* opinion is almost a mini-treatise on how a footage contract is supposed to work. And frankly, the court of appeals reached the correct result merely by applying the contract language as written, leavened with a little common sense. But the opinion also reinforces both the importance of establishing the criteria for the transition to a daywork basis and the usefulness of requiring written notification to the operator before converting to daywork operations.¹⁰³

¹⁰² The Fifth Circuit did, however, reverse the district court’s ruling that the release and indemnity provisions of the contract did not apply for failure to meet the fair notice requirements of Texas law. Because the court found that Dominion had actual knowledge of Paragraph 18’s (now 19) release and indemnity provisions, it did not reach the issue of whether the standard IADC form contract met the “conspicuousness” requirement. The court implied, however, that the IADC form’s warnings and boldface headings met the Texas conspicuousness standard. The court also held Dominion responsible for all cleanup and restoration costs, however. Subparagraph 18.12/19.12 allocated damages due to pollution that originated below the surface of the land to Dominion, without regard to fault; the Dominion’s pollution indemnity was subject to the magic language of Subparagraph 18.15/19.15. Dominion also argued that the saltwater, sand, and chemically treated drilling fluid was not “pollution or contamination” within the terms of the contract. The court of appeals rejected this argument, too.

¹⁰³ See also *Samson Resources Co. v. Quarles Drilling Co.*, 783 P.2d 974, 978 (Okla. App. 1989) (contract did not make express provision for notice to operator of a change from footage to daywork, but court of appeals held that notice was an implied condition of the contract).

VI. Conclusion

The IADC forms are not the preferred contracts for an operator to use. Of course, this does not mean that IADC contracts are “unfair” or “overreaching.” The IADC forms simply represent the contractors’ view of equity and market conditions.

It is critically important to understand where the most significant pitfalls in form contracts are and what can be done to achieve the desired revisions. These are contracts that should not be signed without careful and extensive review. Otherwise, an operator could very easily find itself assuming risks that it would not knowingly have accepted.

Some of the suggested revisions in this paper may not be immediately well-received by drilling contractors without an explanation of what consequence the operator is trying to avoid. Likewise, it is helpful for the operator to *actively listen* to the contractor’s fears regarding a proposed revision to find out whether it can be tweaked to accomplish the intended result without unduly prejudicing the contractor. With time, care, and patience, the parties can usually make the revisions necessary to make the contract acceptable to both of them.