

MASTER SERVICE AGREEMENTS

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MASTER SERVICE AGREEMENTS

- Often oil and gas producers use master service agreements when they expect an ongoing relationship with a service company. These tend to be form agreements that the producers prepare for all their service agreements, and tend to be written favorably in favor of the producer, especially if the producer is big, and has considerable leverage.
- Drilling wells certainly requires a drilling contract, but in addition to the drilling contractor, there are many other contractors that will supply services or goods to the drilling parties. There is the fuel supplier that brings out the diesel, the telephone supplier that supplies the communications equipment, the mud company, the cementing company and several dozen more suppliers that may provide services or goods.
- Keeping track of all of those companies, and entering into separate contracts with them each time they come out frequently becomes a difficult task. What is even more difficult, is if each contract is on a separate or distinct form, with different indemnities and different warranties. It then becomes a nightmare of difficulties if an accident occurs, and property is damaged or lost, or worse, if a person is injured or killed.
- Companies in the mid-1990s began to develop form contracts establishing liability, warranty and insurance agreements that were to govern the relationships between companies whenever they were in use. The individual jobs were perhaps governed by a work order or a purchase order, but the main or central contract governed everything else. Companies would enter into a series of those contracts, so that if Service Provider A was busy or couldn't supply the proper services, then, as a backup, Service Provider B would be called. A typical offshore drilling company can have over 150 master service agreements and about ten different charters for workboats and diveboats, and several different charters for helicopters.
- Example MSAs are in the workbook.
- Many companies, particularly those that supply downhole services are adamant about accepting no liability for anything below the rotary table.
- Tool suppliers require payment for lost profits and for lost tools.
- MSAs and liability allocations are important; remember the problems out in the Gulf and you'll realize what these documents can mean.

MASTER SERVICE AGREEMENTS - INTRODUCTION

INTRODUCTION

Master Service Agreements ("MSA") are an important part of a company's risk allocation program.

A MSA allows a company to implement acceptable terms and conditions in advance without having to negotiate while work is waiting to be performed

Allows a more careful approach to problems concerning risk allocation (such as anti indemnity statutes or other potential restrictions on indemnity or insurance).

A MSA program can promote a consistent approach to risk allocation that allows a company's various MSAs to fit together with other contracts the company will use (such as drilling contracts).

Without a consistent approach, contracts that appear favorable when viewed alone can be inconsistent in that they create unintended exposures.

MASTER SERVICE AGREEMENTS – INTRODUCTION (CONTINUED)

OVERVIEW

- General Description of a Master Service Agreement - A company in the oil and gas business knows that it will often need the services of various contractors to perform different types of work.
 - The agreement establishes how business will be conducted on the work site but it does not address specific jobs. Key areas that are covered in an MSA include warranties, payment terms, liability insurance and risk management. Many MSAs establish the length of the contract, dispute resolution and termination. The MSA sets contractual terms among the companies involved in exploration, drilling, production and service. The agreement outlines the risks and liabilities among contractors and employees through the life of a project. This eliminates renegotiation and disputes as project work changes. .
 - The MSA says nothing about how many hours your company will work or how much revenue you will generate.
 - Your work orders contain specific information about the cost, location and work done on a particular job. If any information in the work order conflicts with the MSA terms, the MSA takes precedence.
 - The MSA is a means for the company to enter into an agreement in advance with its contractors as to what terms and conditions will govern such work.
 - The MSA does not obligate the company to use the contractor or the contractor to accept any particular work, but if the parties agree on particular work, the MSA provides the basic governing terms and conditions.
 - The "contract" to perform a particular job actually results when the owner or operator, in accordance with an MSA, requests the contractor to perform a given task and the contractor agrees.
 - Such work orders (or work requests) can be written or oral, and they will usually contain important business terms, including the type of work, the price, and any applicable time limits
 - Two characteristics, repetition and common work site, provide the basis for a risk allocation scheme between the contractor and the company.

A good master service agreement (MSA) will save time and headaches on a complex project.

In the fast-paced world of oilfield services, it is tempting to take on new business with a handshake. However it is in the best interest of your company and the oilfield operator to have a signed MSA on file.

MASTER SERVICE AGREEMENTS – INTRODUCTION (CONTINUED)

IMPORTANCE OF USING MSA FOR RISK ALLOCATION

One of the main benefits of using an MSA from a risk allocation standpoint is that it allows a company to decide on an approach to risk allocation in advance and then draft the MSA to implement the risk allocation scheme.

- This requires the company to understand its different contracts and think through how they will fit together.
- Make sure the MSA's language about your company accurately describes all of the work you could potentially do for the project. Your company might do welding on a worksite and see the work expand to swabbing or equipment leasing. An MSA that does not include those other services could create liability for your company.
- Negotiate an agreement that focuses on all of your company's services,
- Negotiating the MSA, without the pressure of immediately needing the contractor to perform some work, can be a very important benefit.
- Knowing and understanding the risk allocation scheme in advance allows the company to identify contractual provisions that are most critical.
- These benefits result in the ability to plan ahead and avoid surprises by identifying risk acceptance allowances.

MASTER SERVICE AGREEMENTS – INTRODUCTION (CONTINUED)

MSAS DO NOT WORK FOR ALL TYPES OF CONTRACTS

- Drilling contracts and construction contracts, have very specific issues and are better handled on a single contract basis.
- Vessel charters or flight service agreements, may work well for repeated use but still are specific to require various unique provisions.
- Rental contracts, purchase orders, or contracts for services without a common workplace, may not fit the typical risk allocation approach of an MSA.

MASTER SERVICE AGREEMENTS – INTRODUCTION (CONTINUED)

IT IS CRITICALLY IMPORTANT THAT THE MASTER SERVICE AGREEMENT FIT WITH THE COMPANY'S OTHER CONTRACTS

Risk Allocation Requires Understanding Interaction of Various Contracts

The Importance of the Drilling Contract - The typical drilling contract will allocate certain risks on a reciprocal basis (including personal injury, damage to property, certain pollution risks, and consequential damages), regardless of fault.

- Other risks, such as well control, downhole pollution, loss or damage to the hole or downhole tools, and reservoir damage, are often assumed by the operator, at least to some degree.
- The drilling contract is one of the most important contracts an operator will enter into, and it is the drilling contract that generally creates a framework within which the MSA risk allocation must operate.
- For instance, a drilling contract usually requires the operator to provide indemnity for all of the operator's other contractors, and the company has to make sure that each of its other contracts will match up and provide that protection.

MASTER SERVICE AGREEMENTS – INTRODUCTION (CONTINUED)

As with most contracts, the principal negotiation will be around costs.

Costs for well services contracts may be set by day rates, or they may be based upon a set price for the service provided.

Well service contracts include elements of both services and equipment.

Costs are critical for the producer since they will be reflected in the producer's "authority for expenditure" – the principal document producers use to obtain internal permission and the permission of its joint working interest owners to undertake the operation.

It is also be critical to the service company, since it also determines the profitability of the services rendered.

MASTER SERVICE AGREEMENTS – INTRODUCTION (CONTINUED)

RISK ALLOCATION

After the cost of the service, the next major point of negotiation will be allocation of risk.

When problems arise during drilling and other oil field operations, consequences can be substantial, both in damage to property and in personal injuries.

What's more, problems may arise thousands of feet down hole where direct observation is difficult and it is not always obvious what the problem is, or how it came to pass.

As a result, companies who contract for high risk, high stake services like to eliminate uncertainty with regard to responsibility for consequences relating to problems that arise.

A primary goal for companies entering into oil and gas contracts is to ensure that it is clear who is responsible for damages what various scenarios may come to pass, and to make sure that there are neither gaps in insurance coverage, nor double coverage.

A secondary goal is to reduce the likelihood of protracted litigation resulting from disputes over fault.

MSAs - INDEMNITY

GENERAL RULES ON INDEMNITY PROVISIONS

The most common strategy used by producers and service companies to constrain costs associated with mechanical failure is the so-called “knock for knock” indemnification provision.

Under this provision, each party assumes all risk associated with its own equipment and personal, regardless of fault, and agrees to indemnify the other party for claims arising out of injuries suffered to their own persons and property.

This is also called a “bury your own dead” provision.

The thinking behind this provision is that parties who control their own equipment and personal are in the best position to reduce the risk of failure.

Indemnity is crucial for drilling and other oilfield projects where the risk of injury can be relatively high. Many indemnity clauses also address pollution and environmental damage in light of the 2010 Deepwater Horizon oil spill. Before accepting responsibility for what happens to your workers and equipment, assess the risk of your role in the project. Make sure your company has the right amount of liability insurance to cover that risk. Some MSAs even require contractors to show certificates of insurance to prove that they are covered.

Different states have various laws on the books about knock-for-knock provisions. States like Texas, Louisiana and New Mexico have “anti-indemnity” statutes. These laws are meant to protect smaller contractors from an operator’s negligence. Make sure you understand your company’s legal rights in the state where you operate.

MSAs – INDEMNITY (CONTINUED)

GENERAL RULES ON INDEMNITY PROVISIONS (CONTINUED)

Many legal jurisdictions, however, are uncomfortable with the idea of completely removing fault from allocation of risk. Further, they will not honor choice of law provisions for accidents that happen within their jurisdiction.

In Louisiana, for instance, knock for knock provisions are unenforceable to the extent they apply to personal injuries that happen within the state. The Louisiana legislature determined that “no fault” provisions encouraged carelessness, and that this was against public policy when it came to personal injury. Maritime jurisdictions, on the other hand, have no such anti-indemnity statute. As a result, accidents that occur in offshore Louisiana have often resulted in jurisdiction jockeying by parties and their insurers to obtain favorable application of law.

In addition to anti-indemnity statutes, most jurisdictions also have public laws that require that parties not enter into no-fault contracts that seek to exculpate them from liability stemming from their grossly negligent or intentional acts. For the same reason, waivers of consequential damage provisions are often not applicable against grossly negligent acts.

The distinction between gross and normal negligence is in the eye of the beholder. Courts will often blur the distinction when damages are large, even if the negligence is not. As a result, in instances where the stakes are high, one might expect allegations of gross negligence.

The AI provisions usually void provisions in agreements that "pertain to a well" for oil, gas, or water, in which one party is required to indemnify the other for the indemnified party's fault

MSAs – INDEMNITY (CONTINUED)

GENERAL RULES ON INDEMNITY PROVISIONS (CONTINUED)

- The Texas express negligence requirement applies to strict liability claims
 - The Texas express negligence doctrine applies to a prospective release as well as to indemnity provisions
 - However, an indemnity provision in a settlement and release agreement has been held not to be subject to the express negligence doctrine, the rationale being that its requirements must be met only in agreements that relieve a party in advance of liability for its own negligence
 - It is advisable under all three tests, maritime, Louisiana, and Texas, for the contract to cover not merely indemnification for the "negligence" of the indemnitee, but to specifically include the "sole or concurrent" fault or negligence of the indemnitee.
 - Otherwise, the indemnitor may argue that the provision is not sufficiently clear

MSAs – INDEMNITY (CONTINUED)

EXAMPLE OF INDEMNITY PROVISIONS (CONTINUED)

- Perhaps the best example of how this loophole can play out has been in the litigation over the 2010 BP Macando blowout in the Gulf of Mexico
- In that case, a blowout killed 11 workers and resulted in 4.9 million barrels of oil being released into the waters off the coast of Louisiana. As is often the case in large-scale damage accidents, fingers were pointed at BP, Halliburton, Anadarko, Transocean, Cameron International, among others.
- In this case, the parties had knock for knock indemnity provisions.
- The federal court (following Louisiana law pursuant to the federal offshore continental shelf act) applied the Louisiana Anti-indemnity statute in finding that in order to allocate liability for personal injury, fault must be determined. It also determined that knock for knock provisions did not apply to the application of civil or criminal penalties, insofar as the purpose of the penalties were to deter certain types of behavior, and not to compensate for damages.
- In the Macando oil spill case, the Louisiana court held that knock for knock provisions may be valid even when there are allegations of gross negligence.
- However, the court found that indemnification agreements might be found to be invalid not only for fraud, but even for breach of contract, if that breach is bad enough. BP argued that Transocean had breached its contract in such a way so as to materially increase BP's risk as an indemnitor.

MSAs – INDEMNITY (CONTINUED)

SUBCONTRACTORS

Subcontracting is becoming more common in the oil and gas industry, today comprising as much as 70% of services performed on a typical well. Meanwhile, oil and gas drilling operations are becoming increasingly high-risk endeavors undertaken in difficult circumstances, such as in deep water, in high-pressure zones, or for horizontal drilling.

Subcontractors are not normally “third parties” for purposes of knock for knock provisions, but they may be third party beneficiaries of them.

Subcontractors are often required to be contractually bound by knock for knock or other provisions through what is known in the industry as a “pass through” provision. The producer’s goal with the pass through provision is for the subcontractor to provide language in his contract with the contractor that passes through to the operator. Accordingly, the contractor’s duty to indemnify the operator passes through to the subcontractor. The usual rule is that absent clear language in the subcontractor’s contract providing this result, indemnity obligations will not pass through.

The most troubling aspect of pass through provisions is that they may require subcontractors to take on risk that is disproportionate to the value of their contract. A subcontractor that seeks to break into the oil and gas business may be especially vulnerable to this problem. They are more likely to take on substantial risk in order to open doors into a potentially lucrative new market. This could also be a matter of considerable importance in acquiring insurance.

Subcontractors and contractors alike should be cognizant of problems with pass through provisions arising when parties involved in these may be insolvent. A small subcontractor might end up picking up liability for more than just its own property and personal injury. For this reason, it is important to ensure copies of insurance policies are provided yearly, and policies name the other parties as co-insured. .

MSAs – INDEMNITY (CONTINUED)

OBTAINING PASS-THROUGH PROTECTION - DEFINE COMPANY GROUP

The most important elements are to ensure that the insurance protection is at least as broad as the obligations and that the insurance/indemnity obligations extend to all parties that the operator wants to receive protections.

- The company should use its broadly defined group ("Company Group") to identify the parties entitled to indemnity/insurance protection.
- The company should consider whether there are other entities that should be included in Company Group (such as the company's lessors or any party for whom the operator is performing services).

MSAs - RISK ALLOCATION (CONTINUED)

BASIC INSURANCE REQUIREMENTS TO MAXIMIZE PROTECTION

- Additional Insured

- Being named an additional insured is an affirmative protection that gives the additional insured direct rights under the insurance policy.
- Additional insureds have the same rights as a named insured.

- Waiver of Subrogation

- The company's contracts should also require a waiver of subrogation in favor of all indemnified parties.
- The waiver of subrogation prevents the contractor's insurer from asserting a claim against the indemnified party for its proportionate fault after an accident.

- Primary Coverage

- The third key protection is to require that the insurance provided by the contractor is primary to any other coverage.

MSAs - RISK ALLOCATION (CONTINUED)

Choice of Law Clauses - Provision is desirable because it can be used to attempt to select a legal framework that will allow the intent of the parties to be achieved.

- ❑ The general rule is that a choice of law provision will be honored if the law has a reasonable relation to the parties or the performance of the contract and is not against the public policy of the state.
- ❑ Anti-indemnity statutes can negate a choice of law provision.

MSAs - RISK ALLOCATION (CONTINUED)

OTHER IMPORTANT PROVISIONS RELATING TO RISK ALLOCATION (CONTINUED)

■ Savings Clauses

- A savings clause provides that the invalidity of any particular provision will not invalidate the entire contract.
- Two general approaches to a savings clauses.
- The first approach is to provide that any invalid provision is simply considered deleted and the remainder of the agreement remains valid.
- The second approach, which can be applied in a multi-jurisdiction contract such as an MSA, is to provide that an invalid provision is deemed to be amended to the extent to make it enforceable.

■ Choice of Forum Clauses

- A choice of forum (court) clause provides for a particular forum where both parties agree in advance that a dispute can be resolved.

MSAs - RISK ALLOCATION (CONTINUED)

Arbitration Clauses - An arbitration clause generally provides that disputes arising out of the contract will be resolved by arbitration rather than the courts.

- Such clauses are fully enforceable
- In fact are favored in law
- Arbitration decisions are difficult to appeal.
- Parties must be careful not to waive their right to arbitration by conduct that is inconsistent with the desire to arbitrate a dispute.

CONCLUSION

- It is important to understand how the MSA will interact with other contracts, particularly the drilling contract, and how the risk allocation provisions will be impacted by applicable law.

The MSA may include payment terms and restrictions that conflict with work orders and other contracts. Make sure the MSA does not include language that could limit your company's ability to work and make a profit on the project.

Most MSAs include a termination clause. This spells out what is expected from all parties and what is considered breach of contract. Avoid clauses that call for automatic termination for work not performed in a certain time frame. Avoid termination clauses that are too specific or demanding.

Do not sign anything you do not understand. If your company has never negotiated an MSA before, have a lawyer look at the agreement. If you are familiar with MSAs, there may be terms that are difficult to understand.

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