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Reasonably Prudent Operator or Good and Workmanlike Manner: Does Your Contract Have the Right Standard of Care?

By Parker A. Lee, Ming Lei and Dominique J. Torsiello*

The authors explain the difference between the energy industry's two different standards of care—the "reasonably prudent operator" standard and the "good and workmanlike" standard—and why they should not be viewed as interchangeable or redundant across all energy and infrastructure industries commercial contracts.

The standard of care is an important provision in any operating, management or services agreement because it sets forth the expectations of the parties as to how the contract should be carried out. It also functions as the benchmark by which the service provider's performance under the contract will be measured. Parties on both sides of the table should have a clear understanding of what the standard of performance is under the contract and how it applies to the services provided.

In commercial contracts for energy and infrastructure industries operations, two different standards of care appear most often: The "reasonably prudent operator" standard and the "good and workmanlike manner" standard. We are seeing cases where there is (1) an interchangeability of a "reasonably prudent operator" standard with a "good and workmanlike" standard (or a redundancy of the two), and (2) a general lack of understanding as to what those standards mean.

This article explains the difference between the two standards and why they should not be viewed as interchangeable or redundant across all energy industry commercial contracts.

Given the high concentration of commercial contracts providing operations and services related to oil and gas, heavy infrastructure, petrochemicals and, increasingly, renewable energy projects located in Texas and Louisiana, we have chosen the body of law from those two states as the lens through which to examine these competing standards.

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WHAT ARE THE STANDARDS OF CARE?

Good and Workmanlike Manner

In the general sense, "good and workmanlike manner" means the quality of work performed by one who has the knowledge, training or experience necessary for the successful practice of a trade or occupation and performed in a manner that is generally considered proficient by those capable of judging such work. "Workmanlike" may also be defined as the degree of care that a skilled workman (gender inclusive) would exercise under similar circumstances in the community in which the work is done. Whether work is completed in a good and workmanlike manner is a determination for the factfinder to decide in any litigation.

Reasonably Prudent Operator

The "reasonably prudent operator" standard is seen most commonly in cases involving the development or operation of an oil and gas or mineral lease. As an objective standard, it establishes not only the performance of the obligations, but also whether there is an obligation to begin with (e.g., a lessee's or lease operator's decision to drill or not to drill). Under the reasonably prudent operator standard, the lessee or operator may obligated to make reasonable efforts to develop the interest for the common advantage of both the lessor and lessee. However, courts have also recognized that a lessee or operator's obligation to develop is not unlimited in the sense that it is not mandated to undertake development operations that are unprofitable.

Generally speaking, the implied covenants of a reasonably prudent operator standard include the duty to develop, the duty to protect against drainage, the duty to market and the duty to conduct operations with reasonable care and due diligence. The consideration as to whether someone is acting as a reasonably prudent operator requires the factfinder to consider the cost of development operations and the economic viability therefrom and whether an ordinarily prudent person would have done the same in similar circumstances.

Courts look to the totality of the circumstances and various factors to determine whether an operator has met its development duty, including geological data, the number and location of wells, productive capacity of wells, costs of drilling compared to the profit reasonably expected, time intervals between completion of the last well and demand for additional operations and lease acreage.

TEXAS LAW

Good and Workmanlike Manner

"Texas law 'define[s] good and workmanlike as that quality of work performed by one who has the knowledge, training, or experience necessary for

the successful practice of a trade or occupation and performed in a manner generally considered proficient by those capable of judging such work.' "[1]

The good and workmanlike manner is treated as an implied warranty, which is "created by operation of law and are grounded more in tort than in contract."[2] The implied warranty of "good and workmanlike manner" does not require the repairmen to "guarantee the *results* of their work," but rather only "*perform* those services in a good and workmanlike manner."[3]

This standard is also treated as a "gap filler" warranty that implies terms into a contract that fails to describe how the party or service is to perform. Although the parties cannot disclaim this warranty outright, an express warranty in their contract can fill the gaps covered by the implied warranty "*and supersede it if the express warranty specifically describes the manner, performance or quality of the services*."[4]

For example, in *Gonzalez*:

> [T]he parties agreed that [Southwest] Olshan [Foundation Repair Co., LLC] would perform the work in a good and workmanlike manner, would use the Cable Lock foundation repair system, and would adjust the foundation for the life of the home if the foundation settled. This express warranty sufficiently describes the manner, performance and quality of the services so as to supersede the implied warranty.[5]

Based on this precedent set by the Supreme Court of Texas, even if an agreement utilizes the term "good and workmanlike standard," if the underlying agreement "sufficiently describes" the manner, performance and quality of the services, the terms of the agreement supersede the implied warranty of the good and workmanlike standard and instead becomes an express warranty.[6]

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[1] *Shakeri v. ADT Sec. Services, Inc.*, 816 F.3d 283, 296 n.2 (5th Cir. 2016) (quoting *Melody Home Mfg. Co. v. Barnes*, 741 S.W.2d 349, 354 (Tex. 1987)).

[2] *Continental Dredging, Inc. v. De-Kaizered, Inc.*, 120 S.W.3d 380, 391 (Tex. App.—Texarkana) (quoting *La Sara Grain Co. v. First Nat'l Bank*, 673 S.W.2d 558, 565 (Tex. 1984)).

[3] *Melody*, 741 S.W.2d at 355 (emphasis in original).

[4] *Gonzalez v. Southwest Olshan Foundation Repair Co., LLC*, 400 S.W.3d 52, 59 (Tex. 2013) (emphasis added).

[5] *Id.*

[6] *See e.g.*, *Design Tech Homes, Ltd. v. Maywald*, No. 09–11–00589–CV, (Tex. App.—Beaumont, June 13, 2013, pet. denied) (mem.op.) (holding that the contract entered into between the parties that stated Plaintiff would "construct the house in 'a good and workmanlike manner according to the [p]lans and [s]pecifications" included an express warranty of good and workmanlike performance); *see also e.g.*, *Welwood v. Cypress Creek Estate*, 205 S.W.3d 722, 731 (Tex. App.—Dallas 2006) (even if implied good workmanship warranty applied to developer

In an agreement governed by Texas law, if the parties wish to establish a standard of care different from that of the "knowledge, training, or experience necessary for the successful practice of a trade or occupation and performed in a manner generally considered proficient by those capable of judging such work," they may find it advantageous to set forth the specific manner, performance and quality of the services that are to be provided. In such an instance, by sufficiently setting forth the manner, performance and quality of the services that will be provided under an agreement, the parties can eliminate ambiguity that may arise in any future litigation between. If the parties elect to include such language, it should be clear, measurable and directly applicable to the services performed under the agreement if such language is to have a meaningful impact.

Reasonably Prudent Operator

In Texas, a reasonably prudent operator is an objective standard where the factfinder will decide whether the operator's acts or omissions are like that of a reasonably prudent operator under the same or similar circumstances. The reasonably prudent operator, having an expectation of profit, must act in good faith, with competence and with due regard to the interests of the lessor and its own interests.[7]

In reviewing Texas case law, the reasonably prudent operator standard appears to be applied in the context of oil, gas and mineral leases most of the time. In fact, "[e]very claim of improper operation by a lessor against a lessee should be tested against the general duty of the lessee to conduct operations as a reasonably prudent operator in order to carry out the purpose of the oil and gas lease."[8] Although the following cases analyze mineral lease agreements, the same can be analogized to assume that a court would apply the reasonably prudent operator standard to similar industries.[9]

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services, the warranty was superseded because the agreement provided for the manner, performance, or quality of the services by agreeing to develop the lots in a good and workmanlike manner in accordance with city standards).

[7] *Exxon Corp. v. Miesch*, 180 S.W.3d 299, 323 (Tex. App. Corpus Christi-Edinburg 2005) (reversed on other grounds) (citing *Hurd Enters. v. Bruni*, 828 S.W.2d 101, 109 n.10 (Tex. App.—San Antonio 1992, writ denied)).

[8] *Amoco Production Co. v. Alexander*, 622 S.W.2d 563 (Tex. 1981).

[9] For example, Texas courts have applied a "reasonable and prudent doctor" standard when hearing malpractice cases. *See e.g.*, *Brandt v. Surber*, 194 S.W.3d 108 (Tex. App. Corpus Christi-Edinburg 2006) (The doctor-patient relationship "imposed a duty on Dr. Burke to act as a 'reasonable and prudent doctor' would have acted 'under the same or similar circumstances.' ") (quoting *Hood v. Phillips*, 554 S.W.2d 160, 165 (Tex. 1977)).

Where a lease agreement includes a requirement " 'to drill such offset well or wells on said lands . . . as a reasonably prudent operator would drill under the same or similar circumstances'—[it] expressly adopts the reasonably prudent operator standard."[10]

In *Grayson v. Crescendo Resources, L.P.*,[11] the plaintiffs filed suit based upon the defendant's alleged failure to act as a reasonably prudent operator in developing an oil and gas lease. The court recognized that where a lessee's obligation to develop is not specifically addressed, the law implies a covenant to reasonably develop the premises.[12] "The lessee's duty under that covenant is to act as a reasonably prudent operator under the same or similar circumstances."[13]

In conjunction with the reasonably prudent operator analysis, Texas courts are expected to use this standard to determine whether an exculpatory clause in an agreement should bar or limit a plaintiff's claim. Where a contract's exculpatory clause specifies that the operator "shall conduct and direct and have full control of all operations on the Contract Area" and "shall conduct all such operations in a good and workmanlike manner. . . ." Texas intermediate appellate courts have uniformly found the phrase "all such operations" referred back to "operations on the Contract Area," and held that the exculpatory clause was limited to the operator's activities at the wellsite and did not extend to other breaches of the agreement.[14] "The operator's limitation of liability is linked directly to imposition of the duty to act as a prudent operator, which strictly concerns the manner in which the operator conducts drilling operations on the lease," explained a Texas appellate court.[15]

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[10] *Mzyk v. Murphy Exploration & Production Company—USA* (Tex. App.—San Antonio 2017) (citing *Good v. TXO Prod. Corp.*, 763 S.W.2d 59, 61 (Tex. App.—Amarillo 1988, writ denied) (reaching the same conclusion about identical language in a similar lease provision)).

[11] *Grayson v. Crescendo Resources, L.P.*, 104 S.W.3d 736 (Tex. App.—Amarillo 2003).

[12] The covenant to develop is only implicated after production is secured and requires the lessee to act with reasonable diligence so that the operations result in a profit to both lessor and lessee. *Clifton v. Koontz*, 325 S.W.2d 684, 693 (1959). The obligation to drill additional wells depends on the facts of each particular case. *Senter v. Shanafelt*, 233 S.W.2d 202, 206 (Tex. App.—Fort Worth 1950).

[13] *Grayson*, 104 S.W.3d at 739 (citing *Amoco Production Co. v. Alexander*, 622 S.W.2d 563, 567–68 (Tex. 1981)).

[14] *MDU Barnett Ltd. Partnership v. Chesapeake Exploration Ltd. Partnership*, No. H-12–2528 (S.D. Texas, February 14, 2014) (citing *IP Petroleum Co. v. Wevanco Energy, LLC*, 116 S.W.3d 888, 895 (Tex. App.—Houston 2003, pet. denied) and *Cone v. Fagadau Energy Corp.*, 68 S.W.3d 147, 155 (Tex. App.—Eastland 2001, pet. denied)).

[15] *Id.* (quoting *Abraxas Petroleum Corp. v. Hornburg*, 20 S.W.3d 741, 759 (Tex. App.—El Paso 2000, no pet.).

More recently, in March 2021, a Texas court of appeals similarly held that an exculpatory clause,[16] and those comparable to it, "exempt[ ] the operator from liability for its activities unless its liability-causing conduct is due to gross negligence or willful misconduct."[17]

LOUISIANA LAW

Good and Workmanlike Manner

While Louisiana courts have not adopted a universal definition for the term "workmanlike," courts have applied an objective industry standard. "As a general rule, there is implied in every contract for work or services that the work will be performed in a skillful, careful, diligent and good workmanlike manner."[18]

Significantly, a contractor is not responsible for defects caused by faulty or insufficient specifications furnished to the contractor.[19] "If the defect in construction is caused by faulty or insufficient plans or specifications, the contractor is immune from liability upon constructing compliance therewith, provided the specifications are not provided by him."[20]

In Louisiana, "implicit in every building contract is the requirement that the work shall be performed in a good, workmanlike manner, free from defects in material and workmanship."[21] "The contractor is liable for failure to perform properly."[22]

Louisiana statute Section 2771 provides that:

> No contractor, including but not limited to a residential building

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[16] The exculpatory clause at issue provides: "Operator [BPX] shall conduct its activities under this agreement as a reasonably prudent Operator, i.e., in a good and workmanlike manner, with due diligence and dispatch, in accordance with good oilfield practice, in compliance with the applicable lease(s) and agreements and in compliance with the applicable law and regulation. It shall have no liability as Operator to the other Parties for losses sustained or liabilities incurred, except such as may result from gross negligence or willful misconduct."

[17] *Crimson Exploration Operating, Inc. v. BPX Operating Company*, No. 14–20–00070–CV (Tex. App.—Houston, March 2, 2021).

[18] *Hogan Exploration, Inc. v. Monroe Engineering Associates, Inc.*, 430 So. 2d 696, 700 (La. App. 2d Cir. 1983) (citations omitted).

[19] *Peterson Contractors, Inc. v. Herd Producing Co.*, Inc., 811 So. 2d 130, 133 (La. App. 2d Cir. 2002) (citing La. R. S. 9:2711; *Tex-La Properties v. South State Ins. Co.*, 514 So. 2d 707 (La. App. 2 Cir. 1987)).

[20] *Id.*

[21] *Allstate Enterprises, Inc. v. Brown*, 907 So. 2d 904, 912 (La. App. 2d Cir. 2005) (citing *Davidge v. H & H Construction Co.*, 432 So. 2d 393 (La. App. 1st Cir. 1983)).

[22] *Id.* (citing La. C. C. art. 2769).

> contractor as defined in R.S. 37:2150.1(9), shall be liable for destruction or deterioration of or defects in any work constructed, or under construction, by him if he constructed, or is constructing, the work according to plans or specifications furnished to him which he did not make or cause to be made and if the destruction, deterioration, or defect was due to any fault or insufficient of the plans or specifications. This provision shall apply regardless of whether the destruction, deterioration, or defect occurs or becomes evident prior to or after delivery of the work to the owner or prior to or after acceptance of the work by the owner. The provisions of this Section shall not be subject to waiver by the contractor.[23]

The good and workmanlike standard is more general than the statute. In Louisiana, "[a] contractor is obligated to perform the work in a good and workmanlike manner so that the work is suitable for its intended purpose and free from defects in material and workmanship."[24]

Reasonably Prudent Operator

Similar to the case law review in Texas, the concept of a reasonably prudent operator appears in the context of oil and gas and mineral leases. Louisiana Mineral Code 31:122 "requires the lessee to act as a 'reasonably prudent operator' based upon the totality of the facts" and allows parties to stipulate what shall constitute reasonably prudent conduct on the part of the lessee.[25] The implied duty imposed on a mineral lessee by La. R.S. 31:122 is also imposed on assignees or sublessees.[26]

In determining whether a lessee is acting as a reasonably prudent operator, a court must consider the totality of the circumstances bearing on the lessee's overall operations. . . ."[27] Significantly, the mineral code in Louisiana is applicable to all materials. "Thus, because the same code article governs the duties to operate under any mineral lease, be it brine or hydrocarbons, we

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[23] LSA-R.S. 9:2771.

[24] *Lewis v. La Adrienne, Inc.*, 17 So. 3d 1007 (La. App. 2d Cir. 2009) (citing to *Cascio v. Henry Hayes Carpet*, 968 So. 2d 844 (La. App. 2d Cir. 2007) (*Mount Mariah Baptist Church v. Pannell's Associated Electric, Inc.*, 835 So. 2d 880 (La. App. 2d Cir. 2002)).

[25] *Ferrara v. Questar*, 70 So. 3d 974, 982 (La. App. 2d Cir. 2011); LSA-R.S. 31:122.

[26] Significantly, even in the event that a mineral lease is assigned to another lessee, the "assignor or sublessor is not relieved of his obligations . . . under a mineral lease unless the lessor has discharged him expressly and in writing." *Rainbow Gun Club, Inc. v. Denbury Resources, Inc.*, 247 So. 3d 844, 848 (La. App. 3d 2018) (citing La. R.S. 31:129).

[27] *Id.*

[Louisiana Supreme Court] find that the interpretation of those duties, should likewise be the same, whether it be for operators of brine or hydrocarbon mines."[28]

The Louisiana Supreme Court explained that "develop and operate" as related to a lessee's actions as a prudent operator are terms of art within the oil and gas industry. " 'Develop,' as used in the industry, 'contemplates any step taken in the search for, capture, production and marketing of hydrocarbons.' 'Operate' can be defined as any activity leading to the production of oil and gas."[29]

Louisiana's First Circuit Court of Appeal has held that even though a company was not the "operator" of the facility, the company had a duty to act in a reasonable and prudent manner because it assumed a "hands-on" role in the milling, pressurization and plugging of the well.

Thus, even if a company does not hold the title of "operator," it may nonetheless be required to act in a reasonable and prudent manner should its actions equate to that of an operator.

WORDS HAVE MEANING

As an increasing number of oil and gas professionals, investors and contract drafters find themselves working in different parts of the energy and infrastructure industries, there are cases where concepts historically specific to oil and gas development activities are copied in an attempt to apply them more broadly. This seems to be the case with the use of a "reasonably prudent operator" standard in commercial contracts for petrochemical facilities and renewable energy projects. As noted above, the "reasonably prudent operator" standard is historically a specific term of art to describe the lessee's obligations to the lessor under the terms of an oil and gas or mineral lease. The parties should ask themselves what standard of care is appropriate for the particular services being provided.

Even within oil and gas-related agreements, such as gathering and transportation services agreements, management or master services agreements or development or operation services agreements, does it make sense to apply a "reasonably prudent operator" standard, which is historically tied to the obligations of a lessee under an oil and gas lease to a party providing services to non-operated properties? Would it be clearer to specifically state what the service provider's obligations are than to leave it to a judge to import a "reasonably prudent operator" standard onto non-operated properties? Or

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[28] *Id.*

[29] *Broussard v. Hilcorp Energy Company*, 24 So. 3d 813, 819–20 (LA. 2009).

should it be both? The form AAPL 1989 Operating Agreement provides that, "[o]perator shall conduct its activities under this agreement as a reasonably prudent operator, in a good and workmanlike manner, with due diligence and dispatch, in accordance with good oilfield practice, and in compliance with applicable law and regulation. . . ."

Where a "good and workmanlike manner" standard of care is applied, the parties should think critically before adding or modifying terms. Do the parties really want services to be performed at a different standard than the "knowledge, training, or experience necessary for the successful practice of a trade or occupation and performed in a manner generally considered proficient by those capable of judging such work?" If so, should that change the consideration due to the service provider?

When drafting commercial contracts with respect to operations, management or services in the energy and infrastructure industries, parties should focus on the services being provided and the assets those services relate to, negotiate the proper standard of care in an informed manner and clearly describe that standard in a way that matches up with terms of art under the governing body of law.