Docket #0042 Date Filed: 11/8/2024

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re: ZACHRY HOLDINGS, INC., *et al.*, *Debtors*.	Chapter 11 Case No. 24-90377 (MI)

FLNG LIQUEFACTION, LLC; FLNG LIQUEFACTION 2, LLC; and FLNG LIQUEFACTION 3, LLC, Plaintiffs, v. CB&I INC.; ZACHRY INDUSTRIAL, INC.; and CHIYODA INTERNATIONAL CORPORATION, Defendants.	§ § § § § § § § § § § § § § §	Adversary No. 24-03195

PLAINTIFFS' RESPONSE TO ZACHRY INDUSTRIAL, INC.'S
RULE 12(b)(6) MOTION TO DISMISS

FLNG Liquefaction, LLC, FLNG Liquefaction 2, LLC, and FLNG Liquefaction 3, LLC (collectively, "FLNG" or the "Plaintiffs") file this Response to Zachry Industrial, Inc.'s ("Zachry") Rule 12(b)(6) Motion to Dismiss Plaintiffs' Claim for Consequential Damages, respectfully showing as follows.

I. INTRODUCTION

Freeport LNG Development, L.P. owns and operates a natural gas liquefaction and liquified natural gas ("LNG") export facility in Freeport, Texas (the "LNG Facility"). Plaintiffs contracted with Zachry, CB&I Inc., and Chiyoda International (collectively, "Contractors") to expand the LNG Facility to add three new trains (referred to as Train 1, Train 2, and Train 3) under three

separate, but virtually identical, fixed price, turnkey, engineering, procurement, and construction agreements (the "EPC Contracts"). Following the discovery of significant defects in the motors of the three trains, Plaintiffs filed suit against the Contractors in state court to recover the substantial repair costs, losses due to the shut-down of operations, and other damages. Following Zachry's bankruptcy petition, Plaintiffs' lawsuit was stayed, subsequently removed to federal court and assigned to this adversary action.

Zachry now seeks to dismiss Plaintiffs' claim for consequential damages. As the sole basis for its motion to dismiss, Zachry argues that under Article 2 of the Uniform Commercial Code ("UCC"), Plaintiffs must establish that the waiver of consequential damages contained in the EPC Contracts is unconscionable. However, the UCC does not apply to the EPC Contracts because the essence of the transactions reflected by those agreements is for Contractors to provide complete turnkey construction services, and not solely goods. Indeed, Zachry has not cited a single construction case applying the unconscionability standard to waivers of consequential damages. Rather, Texas law is clear that pre-injury waivers of consequential damages purporting to relieve a party of the consequences of its own gross negligence are void as against public policy. Because Plaintiffs have alleged gross negligence, they have stated a claim that would entitle them consequential damages. For these reasons and as more fully discussed below, dismissal is inappropriate at the pleadings stage.

II. ARGUMENT & AUTHORITIES

A. Dismissal Standard

"A motion to dismiss for failure to state a claim is not meant to resolve disputed facts or test the merits of a lawsuit." *Sewell v. Monroe City Sch. Bd.*, 974 F.3d 577, 581 (5th Cir. 2020); *Oyekwe v. Rsch. Now Grp., Inc.*, 542 F. Supp. 3d 496, 502 (N.D. Tex. 2021). A motion to dismiss

"instead must show that, even in the plaintiff's best-case scenario, the complaint does not state a plausible case for relief." *Sewell*, 974 F.3d at 581. In ruling on such a motion, the court must accept the factual allegations of the complaint as true, view them in a light most favorable to the plaintiff, and draw all reasonable inferences in favor of the plaintiff. *Hernandez v. Mesa*, 582 U.S. 548, 550 (2017); *Ramirez v. Guadarrama*, 3 F.4th 129, 133 (5th Cir. 2021).

To survive a Rule 12(b)(6) motion to dismiss, the plaintiff must merely plead "enough facts to state a claim to relief that is plausible on its face." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 547 (2007). "A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Gonzalez v. Kay*, 577 F.3d 600, 603 (5th Cir. 2009) (quoting *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009)).

B. Plaintiffs have adequately plead their claim for consequential damages.

As the sole basis for their motion to dismiss Plaintiffs' claim for consequential damages, Zachry argues that the EPC Contract contains a consequential damages waiver, and under Article 2 of the UCC, "the sole way to avoid enforcement of an agreement to limit or exclude consequential damages is to show that the waiver was unconscionable." ECF No. 39, p. 6. Zachry's argument hinges on the application of the UCC to the EPC Contracts. However, the UCC does not govern the EPC Contracts, and Texas law is clear that pre-injury waivers of consequential damages are void as against public policy in instances of gross negligence, which Plaintiffs have alleged.

1. The EPC Contracts are not contracts for the sale of goods.

The Texas UCC "applies to transactions in goods." TEX. BUS. & COM. CODE § 2.102. "Goods" are defined as "all things (including specially manufactured goods) which are movable at the time of identification to the contract." *Id.* § 2.105(a). In hybrid transactions that involve the

sale of both services and materials, Texas courts have held that "the question becomes whether the dominant factor or 'essence' of the transaction is the sale of the materials or the services." *G-W-L, Inc. v. Robichaux*, 643 S.W.2d 392, 394 (Tex. 1982) (holding that a building contract is not covered by the UCC), overruled on other grounds by *Melody Home Manufacturing Co. v. Barnes*, 741 S.W.2d 349, 355 (Tex. 1987); *see also Montgomery Ward & Co., Inc. v. Dalton*, 665 S.W.2d 507, 511 (Tex. App.—El Paso 1983) (contract for installation of roof was not covered by the UCC); *Freeman v. Shannon Construction, Inc.*, 560 S.W.2d 732, 737 (Tex. Civ. App.—Amarillo 1977, writ ref'd n.r.e.) (contract for cement work on a project was not covered by the UCC); *Tex. Dev. Co. v. Exxon Mobil Corp.*, 119 S.W.3d 875, 881 (Tex. App.—Eastland 2003, no pet.) (Chapter 2 did not apply to an agreement calling for the design of rig modifications, the fabrication and installation of those modifications, and the structural assessment of the drilling unit).

Courts have found contracts "to install flooring or a drainage system, to build a house, to complete a chimney, or to construct or install a swimming pool or a shingled roof" to be primarily for the "rendition of services" because "even though such contracts include the cost of materials" the goods are "incidental." *Propulsion Techs., Inc. v. Attwood Corp.*, 369 F.3d 896, 902 (5th Cir. 2004) (contract to produce custom designed propeller castings was a contract for the sale of goods). A contract that involves the sale of both goods and services falls under Chapter 2 only "if the sale of goods is the dominant factor." *Tex. Dev. Co.*, 119 S.W.3d at 881.

Under the EPC Contracts, Zachry was obligated to perform the "Work." EPC Contracts § 3.1(a). The EPC Contracts define "Work" to mean:

> all obligations, duties and responsibilities required of Contractor pursuant to this Agreement, including all Equipment, construction equipment (including materials, apparatus, structures, supplies, tools, machinery, equipment and scaffolding), spare parts, ***procurement***, ***engineering***, ***design***, ***fabrication***, ***erection***, ***installation***, ***manufacture***, ***delivery***, ***transportation***, ***storage***, ***construction***, ***workmanship***, ***labor***, ***pre-commissioning***, ***commissioning***, ***inspection***, ***training***, ***Performance***

> ***Tests***, ***other tests***, ***start-up*** and ***any other services***, work or things furnished or used or required to be furnished or used, by Contractor in the performance of this Agreement, including that set forth in Attachment A and Section 3.1A and ***any Corrective Work***.

EPC Contracts § 1.1, pp. 19-20 (emphasis added). Additionally, procuring "equipment" was only a portion of one of the more than 18 enumerated "Specific Obligations" that Zachry was required to do to perform the Work. EPC Contracts § 3.2. The remaining obligations under § 3.2A, as well as the other 17 enumerated subsections of Section 3.2, required Zachry to perform services and other obligations. In fact, the EPC Contracts for Trains 1 and 2 allocate 56% of the total Contract Price to "Labor and Skills," and the EPC Contract for Train 3 allocates more than 63% of the total Contract Price to "Labor and Skills." EPC Contracts § 7.1. This is further evidence that the purpose of the EPC Contracts was primarily for the sale of services, not goods. Because Zachry was required under the EPC Contracts to perform all services required to construct functioning LNG trains on a turnkey basis, the essence of the transactions under the EPC Contracts was the sale of services.

It is telling that Zachry could not cite to a single case applying § 2.719(c) to *any* construction contract, much less a comprehensive turn-key construction contract like the EPC Contracts. *See Safety Vision LLC v. LEI Tech. Canada*, -- F. Supp. 3d ---, No. 4:21-CV-03306, 2024 WL 3094649, at *6 (S.D. Tex. June 20, 2024) (applying limitation of consequential damages to manufacturer of commercial video monitoring equipment); *Bray Int'l, Inc. v. Computer Assocs. Int'l, Inc.*, No. CIV H-02-0098, 2005 WL 3371875, at *4 (S.D. Tex. Dec. 12, 2005) (construing consequential damages waiver in software license agreement); *Lindemann v. Eli Lilly*, & Co., 816 F.2d 199, 203 (5th Cir. 1987) (applying consequential damages waiver in action against herbicide manufacturer); *Eastman Chem. Co. v. Niro, Inc.*, 80 F. Supp. 2d 712, 719 (S.D. Tex. 2000) (applying consequential damages waiver in action against manufacturer of spray fluidizer dryer).

2. Pre-injury waivers of consequential damages are void in instances of gross negligence.

Zachry argues that the EPC Contracts were "heavily negotiated by highly sophisticated commercial entities." ECF No. 39, p. 7. But freedom of contract has its limits. "[P]arties have the right to contract as they see fit, as long as their agreement does not violate the law or public policy." *Zachry Constr. Corp. v. Port of Hous. Auth. of Harris Cnty.*, 449 S.W.3d 98, 117 (Tex. 2014). The Texas Supreme Court has held "a contractual provision exempting a party from tort liability for harm caused intentionally or recklessly is unenforceable on grounds of public policy" and "the same may be said of contract liability [because] [t]o conclude otherwise would incentivize wrongful conduct and damage contractual relations." *Zachry*, 449 S.W.3d at 116; *see also Bachtell Enter., LLC v. Ankor E&P Holdings Corp.*, 651 S.W.3d 514, 521 (Tex. App.—Houston [14th Dist.] 2022, pet. denied) (exculpatory clause in a joint operating agreement is to protect the operator from liability "caused by the operator's *ordinary negligence*.") (emphasis in original); *Van Voris v. Team Chop Shop, LLC*, 402 S.W.3d 915, 924 (Tex. App.—Dallas 2013, no pet.); *Brennan v. Kaufman*, No. 14-19-00513-CV, 2021 WL 3729257, at *6 (Tex. App.—Houston [14th Dist.] Aug. 24, 2021, pet. denied); *Fairfield Ins. Co. v. Stephens Martin Paving, LP*, 246 S.W.3d 653, 687 (Tex. 2008) (Hecht, J., concurring); *Crowell v. Hous. Auth. of Dallas*, 495 S.W.2d 887, 889 (Tex. 1973); *Sw. Elec. Power Co. v. Grant*, 73 S.W.3d 211, 219–22 (Tex. 2002) (suggesting that a tariff or contract provision including a pre-injury waiver of liability for gross negligence or willful misconduct may be so unreasonable as to violate public policy); *Sydlik v. REEIII, Inc.*, 195 S.W.3d 329, 336 (Tex. App.—Houston [14th Dist.] 2006, no pet.) (pre-injury waiver of liability for gross negligence is against public policy).

In a prior case before the Texas Supreme Court, Zachry successfully voided a contract provision waiving consequential damages based on gross negligence. *Zachry*, 449 S.W.3d at 116.

That case involved a contract with the Port of Houston Authority of Harris County to construct a wharf on the Bayport Ship Channel. The contract contained a no-damages-for-delay provision that stated that Zachry could not recover from the Port "any damages arising out of or associated with any delay or hindrance" to its work, even if due to the Port's "negligence, breach of contract or other fault", and that its "sole remedy in any such case" would be "an extension of time." *Zachry*, 449 S.W.3d at 115. In response to Zachry's argument that the provision was unenforceable, the Port argued that "Zachry is a sophisticated party, a very large construction company that can protect itself," mirroring Zachry's argument here. *Zachry*, 449 S.W.3d at 118. The Texas Supreme Court agreed with Zachry and joined the "overwhelming consensus" of other states by concluding that "pre-injury waivers of future liability for gross negligence are void as against public policy." *Zachry*, 449 S.W.3d at 116.

Because the consequential damages waivers in the EPC Contracts are void in instances of gross negligence, and Plaintiffs have alleged gross negligence,[1] Zachry's motion to dismiss Plaintiffs' claim for consequential damages should be denied.

C. Alternatively, Plaintiffs should be given an opportunity to replead.

Generally, a court should not dismiss an action for failure to state a claim under Rule 12(b)(6) without giving the plaintiff an opportunity to amend. *Hart v. Bayer Corp.*, 199 F.3d 239, 248 n.6 (5th Cir. 2000) (plaintiff's failure to meet the specific pleading requirements should not automatically or inflexibly result in dismissal of the complaint with prejudice to refiling); *accord Strickland v. Bank of N.Y. Mellon*, 838 F. App'x 815, 821 (5th Cir. 2020); *Young v. U.S. Postal Serv. ex rel. Donahoe*, 620 F. App'x 241, 245 (5th Cir. 2015); *Goldstein v. MCI WorldCom*, 340 F.3d 238, 254 (5th Cir. 2003). In the event the Court believes that Plaintiffs have failed to sufficiently

[1] *See* Plaintiffs' Original Petition ¶¶ 61-64.

allege facts supporting their claim for consequential damages, Plaintiffs request an opportunity to replead.

III. CONCLUSION

Because the UCC does not apply to the EPC Contracts, Plaintiffs are not required to allege unconscionability to recover consequential damages. Thus, the sole basis for dismissal raised by Zachry should be rejected, and its motion to dismiss be denied. Alternatively, Plaintiffs seek leave to amend.

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I certify that on November 8, 2024, I caused a true and correct copy of the foregoing document to be served by the Court's ECF service on all parties registered to receive notice in this case on the following:

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