THE UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

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FLNG LIQUEFACTION LLC, et al	*	ADVERSARY NO. 24-03195
	*	Houston, Texas
	*	
vs.	*	11:01 a.m. - 11:20 a.m.
	*	
CB&I INC., et al	*	December 13, 2024

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MOTION [39] HEARING
RULING BY THE COURT

(Teleconference)

BEFORE THE HONORABLE MARVIN ISGUR
UNITED STATES BANKRUPTCY JUDGE

* * * * *

Proceedings recorded by electronic sound recording
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APPEARANCES:

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P R O C E E D I N G S

11:01 A.M. - DECEMBER 13, 2024

THE COURT: All right. Good afternoon, we -- or good morning. We are here in the Zachry Holdings case, Adversary Proceedings No. 24-3195, FLNG Liquefaction vs. CB&I, et al.

If you are here in that case and wish to speak today, please press 5*. If you wish to make an appearance, please do so electronically; unless you're in court, you can come forward and make your appearance.

MR. THOMAS: Good morning, Your Honor. John Thomas with Hicks Thomas, LLP, Special Litigation Counsel for the Debtors. I was in the courthouse anyway, so I thought I'd just be here in person. Thank you.

THE COURT: That's fine.

Mr. Taylor, I know that I said people aren't really going to be given an opportunity to argue today, but in case anyone wants to make objections to anything, I certainly want to have you available.

Is that you that I just enabled?

MR. TAYLOR: It is, Your Honor. Chris Taylor on behalf of the Plaintiff.

THE COURT: Thank you.

All right. Unless anyone has any preliminary statements to make, I'm going to make the ruling. All right. This is an oral ruling. This ruling is interlocutory. Nevertheless, we will reduce this to writing at some point. But the substance of the ruling that is reduced to writing will be the same as what we're doing here.

The Court today will dismiss the claims in this case for consequential damages. That will include, among other things, claims for lost profits.

FLNG's removed action seeks damages from Zachry's alleged breach of the EPC contracts, and the alleged breach concerns defects in the design and assembly of hardware located inside the GE motors. FLNG seeks damages for repair costs, shutdown of operations, and lost profits.

Zachry seeks dismissal of the claims for lost profits and consequential damages, citing Section 20.5 of the EPC contracts, which read as follows:

Consequential Damages. Notwithstanding any other provisions of this agreement to the contract, neither owner nor contractor shall be liable to each other under this agreement or under any cause of action related to the subject matter of this agreement, whether in contract towards, including negligence,

strict liability, **[xx]** liability, indemnity, contribution, or any other cause of action for special, indirect, incidental, or consequential losses or damages, including loss of profits, use, opportunity, revenues, financing, bonding capacity, or business interruptions. And owner and contractor, on behalf of themselves, hereby waive and release each other of all such losses and damages.

From a pure contractual point of view, the Court sees no ambiguity and this consequential damages waiver would prevent FLNG from recovering any consequential damages from Zachry.

However, in Texas, public policy overrides consequential damage waivers in cases of gross negligence. And one of the leading cases on that is a Texas Supreme Court case also involving Zachry: *Zachry Construction Corp. vs. The Port of Houston Authority of Harris County*, citing 449, S.W.3d, 98, Texas Supreme Court 2014, which reads that "a contractual provision exempting a party from tort liability for harm caused intentional or recklessly is unenforceable on grounds of public policy. And the same may be said of contract liability [because] to conclude otherwise would incentivize wrongful conduct and damage contractual relations."

I also, however, refer to *Sharyland Water Supply Corporation vs. The City of Alton,* a Texas Supreme Court case at 354 [S.W.3d] 407 in 2011, holding that "even a gross negligence finding would not support the recovery of purely economic losses in a case that could only be characterized as a breach of contract." I did not cross that bridge in this case because I think that under any circumstance, these are not recoverable damages under the consequential damages exclusion.

FLNG's original Complaint was dismissed by the Court without prejudice and they were granted leave to amend their Complaint to plead more specifically the gross negligence under Rule 8.

Under Texas law, gross negligence is an act or omission:

(1) which, when viewed objectively from the standpoint of defendant at the time of its occurrence, involved an extreme degree of risk considering the probability and magnitude of the potential harm to others; and

(2) of which the defendant had actual subjective awareness of the risk involved, but nevertheless proceeded with conscious indifference to the rights, safety, or welfare of others.

And I'm citing *Diamond Shamrock Refining Company vs. Hall* at *168* S.W.3d 164, a 2005 Texas Supreme Court case.

But that already resisted definition applied by the Texas Supreme Court, it is verbatim included in the Texas Civil Practice and Remedies Code as the definition of "gross negligence" in the state under the definition in Section 41.001(11).

As the Supreme Court explains, what separates ordinary negligence from gross negligence is the defendant's state of mind. In other words, the plaintiff must show that the defendant did not know about the peril, but his acts or omissions -- I'm sorry, that the defendant knew about the peril, but his acts or omissions demonstrate that he did not care.

The facts in *Diamond Shamrock* are worth a very detailed review. The risk and the general awareness of the risk and the severe resulting injuries in *Diamond Shamrock* were all far more indicative of knowledge of the peril than what we have in this case. And inasmuch as the facts in *Diamond Shamrock* Texas Supreme Court opinion are inadequate to demonstrate gross negligence, the facts in the present case, assuming all of the allegations in the Complaint to be true, also cannot sustain a finding of gross

negligence.

But I'm going to spend some time going through that because it heavily influenced the Court's decision looking at what occurred in *Diamond Shamrock.* There were severe physical injuries to individuals in *Diamond Shamrock* and they occurred when there was a refinery explosion. The explosion resulted when a reciprocating gas compressor at a crude oil refinery in Dumas ruptured. This was the third explosion related to the compressor, with the first two occurring 30 years before.

It is common knowledge that crude oil refineries are dangerous, and it was within Diamond Shamrock's specific knowledge that the reciprocal compressor had exploded before. Diamond Shamrock was aware of the possibility that liquids could backflow in the discharge line of the reciprocating compressor, and that the backflow of liquids was the precipitating cause of the explosion.

Diamond installed many years ago a check valve to prevent the backflow and thus reduce the danger. That check valve worked for 15 years. Diamond had actual knowledge that it was necessary for the valve to work properly to reduce the level of danger of the compressor.

Diamond also knew that the check valve, which was necessary to stop the backflow, had developed some leaks. What Diamond did not have subjective awareness of, according to the Supreme Court, was that the leak in the backflow presented a danger of explosion itself.

From past experience, Diamond knew that sending liquids through vapor lines to the compressor could cause explosions. It had happened twice before. Diamond guarded against it with a suction drum that was intended to give off a high-level warning alarm, and that suction drum worked on the day of the explosion.

The compressor was designed so the compressor would shut down before any liquids entered into it. The liquid flow should have stopped sooner, but the Court found the delay was not evidence of conscious indifference. Bleeder valves vented flammable contents of the line into the air. And after the explosion, Diamond modified the valves so they can check for liquids.

The Supreme Court held that its failure to modify the valves pre-explosion may be negligent, but not enough for gross negligence. "Failure to implement redundant safety systems is not on this record any evidence of conscious indifference to the risk of

explosion."

Then the Supreme Court said, "There is no evidence in the present case that Diamond Shamrock intentionally did nothing to protect Hall (the plaintiff) from the risk of explosion."

The Supreme Court found that Diamond Shamrock's errors were akin to those in *Louisiana-Pacific vs. Andrade*, a Texas Supreme Court case from 1999. And in that case employees of the company mistakenly believed that electrical power to an overhead crane had been disconnected. That mistake resulted in the accidental activation of the crane and a workman falling 30 feet to the ground and suffering serious head injuries. The Court concluded that although a mistake had been made and that it resulted in severe injury, there was no conscious indifference to the risk of power activating the crane causing the workman to fall.

FLNG alleges that a large motor inherently involves an extreme degree of risk. And we assume in making this decision that FLNG will have evidence at trial to support that allegation, and we assume it to be true. But as in *Diamond*, the fact that a refinery or a large machine has inherent dangers is inadequate to satisfy the state of mind requirement of the

statute. Inherent dangerousness does not eliminate the requirement for subjective awareness of a specific risk. That was even true when Diamond Shamrock had two prior explosions closely related to the same cause, a fact not even close to being present here.

FLNG's allegation that an awareness of potential for problems due to the size of the motor or its complexity is not enough for an actual subjective awareness of an extreme risk. Regarding the subjective state of mind, Zachry must have somehow had actual awareness of the motor defects inside the closed casing and acted with conscious indifference toward the risk of the motor failing from those defects.

The allegations of the Complaint, even if taken as true, do not suggest that Zachry knew about the internal defects and turned a blind eye to them. The allegations in a light most favorable to FLNG suggest that Zachry knew how large the motors were and failed to suggest GE's assembly of the motors properly. That is not, under the law, conscious indifference to the risk of loose bolts causing the failure of the system.

In *Diamond Shamrock* it was held that failure to take further precautions with respect to the compressor might have been negligence, but simple

negligence alone is not sufficient to establish gross negligence.

The Complaint, the arguments from FLNG appear to impose almost a strict liability, products liability requirement on Zachry. That is that by virtue of the size of the motor, any level of negligence on the part of Zachry, ordinary negligence and other circumstances, rises to the level of gross negligence because the machine was large and new and complicated.

I believe that lesson is the opposite of the teachings in *Diamond Shamrock* and in *Louisiana-Pacific* and I reject it. I think that would be a perfectly rational system. I just don't think it is our system.

For those reasons, we find that the Amended Complaint fails to plead gross negligence sufficiently. This is FLNG's second attempt and the allegations, in my view, do not come close to meeting Rule 8's requirements of stating facts that would give rise to a gross negligence finding.

FLNG expressed in closing arguments to the Court its concerns about dismissing the claim at the pleading stage, and they cite to some of the cases that we've already dealt with and to others and point out

that they are unable to locate where gross negligence claims are dismissed at the pleading stage in state court.

The issue of whether there was gross negligence must be substantively determined in accordance with Texas law. That is what we're doing. But the issue of whether a pleading is adequate is a procedural issue under federal law.

The manner in which pleading requirements are enforced is not determined by how the state courts reviewed the adequacy of a complaint and how a federal court reviews the adequacy of the complaint. And although this complaint was initially filed in state court, it was removed to federal court and federal pleading standards apply.

Judge Fitzwater, in the Northern District of Texas, so held in *Wilson vs. Korth Direct Mortgage,* a 2023 case, and he allowed a plaintiff to replead gross negligence under the federal pleading standards, just as we did, when it dismissed the removed case that had been pled under state standards.

In *White vs. Carter Communications,* Judge Fitzwater dismissed a gross negligence claim at the pleading stage for failure to state a claim. For those of you who do not know Judge Fitzwater, I've known him

since he was 19 years old. He doesn't make mistakes like this. I don't think it's a mistake. I respect his findings that we apply federal pleading standards. He didn't allow another opportunity at that stage.

I want to be sure to note that in the cases decided by Judge Fitzwater, I don't think that the complaints were of the really high quality of the complaint that was filed by FLNG in this case. They were poorer complaints. I cite to those not for the analogy of the quality of the complaint, but for the question of whether we're supposed to be applying *Iqbal* and *Twombly* at the pleading stage to deal with gross negligence. And that is what Judge Fitzwater did is apply an *Iqbal/Twombly* pleading stage gross negligence, which is the same thing that we are doing here.

Here we allowed FLNG the opportunity to replead under the federal pleading standard. Under *Iqbal/Twombly*, the plausibility standard requires more than a sheer possibility that a defendant has acted wrongfully.

There must be enough facts to state a claim to relief that is plausible on its face. And the problem here is that even taking a hundred percent of FLNG's allegations as true, the facts simply don't come close to getting rise to a claim for gross negligence

under Texas substantive law. I don't think it's plausible that the failure to inspect the motor during GE's manufacturing process could cause a gross negligence finding under Texas law.

It's important to note in this finding that the alleged facts are largely undisputed by the parties. Questions of fact are matters for trial, but there is no material factual dispute here.

Accordingly, the Motion to Dismiss the claims for consequential damages is granted. FLNG is not entitled to any consequential damages arising from the alleged breach of the EPC contracts or from its negligence. So we will dismiss those claims. Again, I will reduce this to writing and it is a judgment that is now effective today. If the parties wish to file an interlocutory appeal, we will allow parties to do what they need to do about that.

Mr. Jones, go ahead, please.

MR. JONES: Good morning, Your Honor. Charlie Jones with Haynes and Boone on behalf of Chiyoda International. I just wanted to make sure, Chiyoda did join the motion and Your Honor spoke of Zachry in its ruling. I just want to make sure this applies to Chiyoda also. The pleadings talk about contract or lumping all three, Zachry, Chiyoda, and CB&I together.

I just want to make sure it's applied for Chiyoda also.

Thank you, Your Honor.

THE COURT: It's the same effect, yes. Thank you.

MR. JONES: Thank you, Your Honor.

THE COURT: All right. Does anybody at this stage -- and Mr. Taylor, I know I've dumped a lot on you. I'm certainly not trying to force you to advance, state any objections. I just want to leave the floor open for you to do that. But all of your rights to object to what I've done are fully preserved for you to deal with in the future. But I don't want to silence you if there's something you need to say today. So please feel free.

MR. TAYLOR: Again, nothing to add, Your Honor. Thank you.

THE COURT: Thank you.

Anything that you wish to add, Mr. Thomas?

MR. THOMAS: No, Your Honor.

THE COURT: All right. We will get this out. I appreciate all the quality of the argument and the opportunity to deal on this issue. And we'll go ahead and recess. Thank you.

[11:20 a.m. - Proceedings adjourned]

C E R T I F I C A T I O N

I certify that the foregoing is a correct transcript of the electronic sound recording of the proceedings in the above-entitled matter.

/s/ Gwen Reed

12-18-24

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF TEXAS

In Re: Zachry Holdings, Inc. and Statutory Unsecured Claimholders' Committee Debtor	Case No.: 24−90377 Chapter: 11

FLNG Liquefaction LLC,
Plaintiff(s),
vs.
CB&I Inc,
Defendant(s).

Adversary No.: 24−03195

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Nathan Ochsner
Clerk of Court