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Build On This newsletter

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Notes from the Editor

Welcome to the first edition of Build On This for 2012. The new year brings many new legal developments in Ohio and nationally. To help keep you up to speed on these developments, we are featuring an article by Paul Filon explaining the new America Invents Act. Though we usually publish articles more directly related to the real estate industry, this new change in the law is so significant that we thought many of our readers would like to know more about it and how it may impact businesses throughout the country. Of course, we are still dedicated to bringing you practical advice for real estate matters, so we also bring you an article by Fred Lombardi on the proper way to terminate a construction contract. One of the hottest topics in real estate right now is the explosion of oil and gas leasing activity in Ohio and other parts of the country. My article in this month's edition will explain the significance of this activity and why it might not be a good idea to rely on form documents when entering into an oil and gas lease.

We hope you find these articles informative and, as always, we welcome your opinions and feedback.

David J. Lindner
Editor

FEATURE ARTICLES

Construction Law – Termination of the Construction Contract

By: Frederick M. Lombardi

(Author's Note: This article addresses private, not public contracts. Public contracts involve or include different provisions, often prescribed by statute or regulation. Also, there are two kinds of termination: "for cause" and "for convenience." This article addresses "for cause" termination. A future article will focus on termination "for convenience" and damages arising as a result of termination.)

There are many reasons for terminating a construction contract. Some of the most common are nonpayment by the owner or contractor, nonperformance by the contractor or subcontractors, timeliness of performance, lack of communication or simply an inability to get along. These issues should be addressed in a construction contract.

Because termination ends one or both parties' rights or contractual obligations prior to the completion of the project, careful consideration should be given to the consequences. The timeliness of project completion and potential added costs, not to mention exposure to damages, require that termination be approached by both parties with extreme caution and after thorough analysis by legal counsel, construction experts, accountants, architects and other pertinent industry experts.

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Construction Law – Termination of the Construction Contract

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Most construction contract issues can be resolved and every effort should be made to do so through negotiations and, if necessary, compromise before termination. Finding a resolution can help parties avoid the risks of additional delays and costs in the aftermath of termination, exposure to damages, and the uncertainty of legal outcomes when facts are judged and conclusions reached by third-party judges or arbitrators.

“For cause” termination may result when an owner, contractor or subcontractor does not fulfill obligations within the contract. Examples include:

- owner failing to pay the contractor or the contractor to pay its subcontractors or suppliers;
- owner failing to properly coordinate a work schedule where separate contracts exist for discrete parts of the construction project;
- work stoppage by court order through no fault of the contractor (e.g., work stopped by a court or government order due to failure of an architect to issue a certificate of payment that is proper and due, or reasons other than acts of God or force majeure);
- contractor failing to perform in a timely manner or properly coordinating its subcontractors or suppliers;
- contractor failing to perform in terms of the quality or quantity of the work and materials furnished in accordance with the construction contract, the plans and/or the specifications.

Even in these extreme situations, a notice of default and an opportunity to cure the default is generally provided for in the contract and, if not, still should be given in most circumstances. The objective is to give the parties one last chance to avoid termination and the risks associated with it.

When termination is necessary, there are some practical considerations for the owner prior to issuing the termination notice.

First, if the project has performance bond coverage, notice should be provided to the surety in order to utilize the surety as another avenue of approach in an effort to encourage the contractor to cure the default. A surety may take over the project, pay the owner for any liability incurred, find a replacement contractor or deny the claim. The owner should carefully review the terms of the performance bond in order to ensure that all conditions precedent to claiming performance bond coverage have been met.

Second, prior to issuing a termination notice, the owner should consider engaging a qualified construction expert to evaluate the status of the project and to memorialize the existing condition of the project for litigation purposes. A qualified construction expert can advise the owner on the probable cost of completion and the likelihood that the contractor could accelerate or otherwise cure the default. The expert also can provide effective assistance in securing completion of the project.

Based upon the analysis and advice of a qualified construction expert, the owner may find it far preferable to maintain the current contractor and accept a later completion date rather than to terminate under default and suffer even more in terms of completion costs, delays and exposure to litigation.

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Ohio Is the New Hot Spot for Oil and Gas Leasing

By: David J. Lindner

Oil and gas wells are nothing new in Ohio. For decades, operators have drilled throughout the state in search of oil and gas. Recently, however, the application of hydraulic fracturing has made it feasible to drill into the deep Marcellus Shale layer under eastern Ohio and parts of New York, Pennsylvania and West Virginia.

The hydraulic fracturing process involves drilling horizontally into the Marcellus Shale. Millions of gallons of water and sand are then pumped into the rock to fracture it and allow the trapped gas to be released.

In most areas, the shale lies a mile or more below the surface, making it very expensive to initiate a drilling operation; however, the rewards may make it worthwhile. By some estimates, the Marcellus Shale may contain up to 500 trillion cubic feet of gas, of which ten percent may be recoverable. The wellhead value of this amount of gas could be as much as one trillion dollars!

A few thousand feet below the Marcellus Shale lies the Utica Shale, which is thicker and more geographically extensive. The Utica Shale layer may also have great commercial significance in the years to come.

Because of the great potential, operators have been aggressively pursuing oil and gas leases with land owners in the areas where the Marcellus Shale is found. The lease compensation to the land owner typically consists of an initial per-acre signing bonus, which has increased dramatically over the past several years, plus a royalty in the event a producing well is ever drilled.

The customary royalty amount is 1/8 or 12.5%. Although there are many customary terms in oil and gas leases, any lease should be reviewed by an attorney before signing it. Terms can always be negotiated, and the customary terms are not necessarily appropriate or reasonable in every situation.

Due to low natural gas prices, 2010 was an historically slow year for new oil and gas wells in Ohio, but that is expected to change as operations begin to ramp up in Eastern Ohio. Many see the drilling as an economic boon to the state, providing money to landowners as well as jobs to those in the oil and gas and related industries. Governor Kasich's office estimates that shale drilling will create over 200,000 new jobs in Ohio while bringing in an additional 500 million dollars in revenue.

While there is still a great deal of uncertainty about the economic impact of this new oil and gas boom, it is clear that the industry is moving ahead and that new wells will be drilled. The success of these new wells, and fluctuations in gas prices, will determine how extensive new drilling operations become. Both operators and landowners are dealing with variables beyond their control, so it will pay to stay up to date on the latest developments and negotiate leases accordingly, rather than simply relying on standard form documents.

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PATENT REFORM IS HERE

By: Paul C. Filon

Late last year, President Obama signed into law the most comprehensive patent reform in more than half a century. The America Invents Act has provisions with immediate, future, and retroactive effects. Along with redefining prior art and significantly modifying many procedures, the act behooves applicants to consider filing patent applications to protect their inventions as quickly as possible.

The most significant effect of the act will occur March 16, 2013, when the United States will change from a "first-to-invent" system, which has been in place for more than two centuries, to a "first-to-file" system. This will bring the United States in line with the practice in Europe and the rest of the world.

Under the current U.S. system, if more that one independent inventor files for a patent on the same invention, the applicant who was the first to invent is awarded the patent. However, the new first-to-file system will instead award the patent to the inventor who wins the race to the U.S. Patent and Trademark Office (USPTO) by filing an application first. While this may simplify the process of determining who should get the patent, entities with limited resources such as small businesses may be at a significant disadvantage.

Currently, there is a one year grace period for the public disclosure of an invention prior to filing with the USPTO. In other words, an inventor is not prohibited from getting a patent by selling or disclosing the invention for up to one year before filing. Under the new system, independent third party disclosures occurring at any time before the filing date of a patent application may bar patentability except in limited circumstances.

Even more restricting is the elimination of the prior art geographic limitation. The current law precludes patentability on an invention that is known or used by others, in public use, or on sale in the United States more than one year prior to filing the application. The new law removes the geographic limitation so that public use, knowledge, and sales by others anywhere in the world before the filing date will now preclude patentability. The likely effect is that businesses and inventors will be compelled to consider filing applications early and often in an attempt to protect their inventions before something bars patentability.

Other provisions of the act will remove the "best mode" violation as a litigation tactic to invalidate a patent, expand prior commercial use defense, and limit the addition of defendants in patent infringement lawsuits. Each of these provisions is expected to have an immediate impact on businesses and individual inventors. For example, the prior commercial use defense against infringement may now be available to someone who first invents and uses, but does not patent an invention that is later patented by another party. This defense was limited to business method patents under the old law, but the new law will expand it to protect most subject matter related to manufacturing and commercial processes.

From the inventor's perspective, the expansion of prior user protection is expected to impact the decision-making process of whether to seek immediate patent protection for an invention or whether it may be better protected as a trade secret. As a result, non-disclosure agreements may become much more significant to companies and inventors.

Other provisions having immediate or near immediate effect include increases in fees, new patent prohibitions and priority examination. A 15% surcharge has been added to all patent-related fees, including maintenance fees for existing patents. However, there are also fee reductions for small entities and a newly defined "micro entity."

Individuals and entities that qualify as a "micro entity" may be entitled to a 75% reduction in

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certain fees charged by the USPTO. New prohibitions on patentable subject matter include "any strategy for reducing, avoiding or deferring tax liability," which is now considered prior art under most circumstances, and patents on the "human organism." These provisions not only take immediate effect, but they also apply to any pending application or subsequently issued patent.

Additionally, a new mechanism for priority examination of patent applications is now in effect, which should significantly speed up the patent application examination process for qualifying applications.

New post-grant review procedures – also created by the act – will create opportunities for parties to challenge the patentability of a questionable patent more economically through the USPTO instead of filing an expensive lawsuit. A third party will be permitted to challenge a patent "on any ground" within a nine month window after a patent is issued, with a possible six month extension upon a showing of good cause. After the post-grant review period has expired, a new Inter Partes procedure will still allow a third party to challenge patents, but that challenge can be based on other patents or printed publications only.

The America Invents Act constitutes the most significant reform of U.S. patent law in a generation, and all inventors, patent owners and individuals or entities having any interest in a patent or an invention need to understand the changes and how to best utilize them to achieve their objectives.

Buckingham has a team of intellectual property attorneys well versed in the new America Invents Act and patent law in general that you can consult for your intellectual property needs.

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SAVE THE DATE
April 18, 2012

14th Annual Real Estate & Construction Law Seminar

Hilton Akron/Fairlawn
3180 W. Market Street

Registration: 2:30 pm - 3:00 pm
Presentations: 3:00 pm - 5:00 pm
Reception 5:00 pm - 6:00 pm

Welcome
John P. Slagter, Managing Partner of Buckingham

Introduction
James S. Simon, Master of Ceremonies

Key Note Speaker
Robert M. Leggett, FirstMerit Bank

Oil & Gas Leases 101
William L. Caplan and Clay K. Keller

Title Update
Nicholas T. George, Richard J. Lolli and James S. Simon

Case Law Update
David J. Lindner and Anthony R. Vacanti

Closing Remarks and Adjourn
James S. Simon

Reception following the course

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