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Indemnity Agreements: Indemnity Obligations Are Executory Until the Liability Is Fixed; Omnibus Elections in a Bankruptcy Asset Purchase Agreement That Give Fair Notice Bind the Purchaser.

In *Noble Energy, Inc. v. ConocoPhillips Co.*, , a 5:3 majority in an opinion by Chief Justice Hecht, held a purchaser was validly assigned the debtor's undisclosed contractual indemnity obligation. The assignment occurred under a bankruptcy confirmation of the debtor's reorganization plan and agreement to purchase the debtor's assets.

ConocoPhillips Co. and Alma Energy Corp. agreed to exchange oil and gas interests. The agreement provided reciprocal indemnity for environmental claims arising from the exchanged properties. Alma filed for Chapter 11 bankruptcy protection. Noble Energy Inc. bought the erstwhile Conoco properties under an asset purchase agreement in Alma's bankruptcy. It also "assume[d] all duties and obligations as the owner … under any executory contracts."

Conoco was later sued for contamination at one of the properties obtained from Alma. Conoco demanded indemnity from Noble as successor to Alma's obligations under the exchange agreement. Noble refused, claiming the exchange agreement was not an "executory contract" for purposes of the purchase agreement.

The Indemnity Provision of the Exchange Agreement Was Executory and Included in the Obligations Transferred in the Purchase Agreement.

Noble argued the main purpose of the exchange agreement was to swap properties, that the property swap had been consummated and, therefore, the exchange agreement was no longer executory. The supreme court, however, ruled that the indemnity aspect of the exchange agreement was by definition executory and, therefore, assumed by Noble under the purchase agreement. The entire purpose of the exchange was to swap responsibility for the exchanged properties. The indemnity obligation was a central, not incidental, feature necessary to that objective.

The next issue was whether the exchange agreement was part of the obligations Noble undertook in the purchase agreement. The purchase agreement included a specific list of agreements to which it applied, but it also was not limited to the listed contracts. Accordingly, Noble assumed the indemnity obligation under the agreement.

The purchase agreement was also limited to obligations that accrued after closing. The supreme court rejected the contention that the purchase agreement did not apply because the indemnity obligation was fixed by the exchange agreement *before* Noble entered the purchase agreement. The court explained that indemnity obligations do not accrue "until the indemnitee's liability becomes fixed."

The court also relied on the provision in the bankruptcy order that unless an executory contract was specifically referenced or rejected at closing, it was assumed that Noble assumed it. The Exchange agreement was neither specifically referenced nor rejected. The enforceability of catchall provisions in Chapter 11 plans with omnibus

[1] The opinions expressed are solely those of the author. They do not necessarily represent the views of Munsch, Hardt Kopf & Harr, P.C. or its clients.

elections assuming or rejecting a contract depends on the degree of notice, clarity and overall information. If these are sufficient to put a party on notice of the need for specific action, the omnibus election is valid. In this case, the supreme court treated the omnibus election as adjudicatory, not mere boilerplate. It was binding on Noble.

The three justices dissented because they considered the majority decision manifestly inequitable. The dissenters believed that the issue was "whether the bankruptcy proceedings were conducted as they should have" been under 11 U.S.C. § 365. That section controls assumptions of executory contracts. Under § 365, general plan language effects no assumption of an undisclosed executory contracts unless it also approves the assignee's performance assurance as adequate. The dissenters maintain there could have been no assignment without those steps. The majority considered that approval unnecessary because Noble had voluntarily undertaken other indemnity obligations under the assignment without complaint. The dissent responds that without these steps, Alma and Conoco failed to give Noble fair notice of the obligations it was undertaking as required under bankruptcy law.

***Employment Law*: In This Case, No Employer Duty to Control Employee Conduct Beyond Scope of Employment When Employee Assaults a Third Party While at Work.**

In *Pagayon v. Exxon Mobil Corp.*, an altercation with a convenience store employee resulted in the death of a fellow employee's father. The altercation was the climax of an escalating feud involving the three. The father died from incorrect medical treatment. His injuries that would not have otherwise been life threatening. The decedent's family sued the employer for wrongful death. The doctor was not a party because the employer adduced no evidence the physician was willfully or wantonly negligent in providing emergency care as required by Texas Civil Practice & Remedies Code chapter 74. The jury found t4he altercation was not within the scope of employee's employment and that the employer was negligent in failing to control its employee.

Imposition of Duty Is a Question of Law Based on the Classic Balance of Social Utility Against Foreseeability, Probability and Magnitude of Harm.

At issue was whether the employer has a duty of reasonable care to control employees under these circumstances. Whether to impose a duty not previously recognized requires weighing the "the risk, foreseeability, and likelihood of injury against the social utility of the actor's conduct, the magnitude of the burden of guarding against the injury, and the consequences of placing the burden on the defendant." Especial consideration must be given to "whether one party would generally have superior knowledge of the risk or a right to control the actor who caused the harm." This analysis is usually a question of law that concerns the manner of applying the law to the facts of he case.

Texas Rejects the Restatement's Broad Duty of Employers to Control Employee Behavior Outside the Scope of Employment.

Texas law generally imposes no duty to control the conduct of others. But such a duty may arise from a special relationships such as employment. If so, the employer has direct, not vicarious, liability for negligence if employee acts according to the employer's instructions or the employer fails to use reasonable care addressing known risk. According to Chief Justice Hecht's majority opinion, the employment "special relationship" is a narrow exception.

The opinion then considered whether Texas should adopt the broader duty that would exist under §371 of the Restatement (Second) of Torts. §317 provides that an employer has a duty under certain cicumstances to exercise reasonable care over an employee to prevent intentional or unreasonable risks of bodily harm to others even if the employee is outside the scope of employment. The circumstances triggering the §317 duty are if the employee is on the premises or using the employer's personal property by virtue of the employment relationship and the employer knows or should know of the ability, necessity and opportunity to control the employee.

The court refused to adopt §317 because it did not reflect the balancing of risk, foreseeability, burden and likelihood factors required by Texas law. The opinion was also skeptical whether the Restatement Third version of §317 could satisfy Texas law.

The supreme court refused to impose on the employer had a duty to control the employee's conduct outside the scope of employment. It reasoned the risk of this kind of incident is small, the likelihood of injury remote, the

burden on the employer to be significant, and the social utility of imposing such a rule would be relatively small in light of the "bizarre" outcome from a brief, weapon-free, altercation resulting from "simple employee friction."

Justice Boyd concurred in the judgment, but declined to join the opinion. He did not think it provided any general guidance concerning employer duty. He also considered the rejection of § 317 unnecessary to resolve this case and "opportunistic."

***Oil & Gas*: Including the Same Mineral Interest in Two Pooling Agreements Creates Independent Royalty Obligations Even Without Cross-Conveyance.**

In Samson Exploration v. T.S. Reed Properties, Inc., the mineral lessee mistakenly included the same mineral interest in two different pooling agreements. As a result, the royalty owners in both pooling units claimed that they were entitled to royalties on the production from that mineral interest.

The mineral lessee sought to avoid double royalty payments by claiming that the second pooling unit was invalid because it purportedly conveyed the same interest twice. Impracticality – actually, legal impossibility – is a defense only for circumstances created when an event on which the contract was based does not occur without fault of the party invoking the defense. The mineral lessee drafted the agreement creating the overlapping pooling agreements. Therefore, it was not without fault and the impracticality defense

The mineral lessee also sought to invalidate the second pooling unit by arguing that pooling requires a cross-conveyance of mineral interests included in the pooled tract without which the agreement was "illegal" and unenforceable. But a mineral lessee's inability to honor the pooling agreement it drafted is no defense to liability for breaching its contractual obligation.

The supreme court was also unmoved by arguments based on quasi-estoppel and scrivener's error. As to the former, there can be no quasi-estoppel by inconsistency in positions simply because the plaintiffs previously accepted underpayments. Doing so is not inconsistent with asserting that they were contractually entitled to more. Scrivener's error afforded no relief or basis for reformation because the mistake was unilateral, not mutual, and the sole fault of the party seeking to evade its contractual undertaking.

The court also rejected the mineral lessee's attempt to disgorge excess royalty payments. "[M]oney voluntarily paid … with full knowledge of all the facts, in the absence of fraud, deception, duress, or compulsion, cannot be recovered back merely because the party … was ignorant of or mistook the law as to his liability." The mineral lessee had failed to correct the error even though it had many opportunities to do so.

The mineral lessee alleged it was under duress to make the payments under the reasoning of *Samson Lone Star, Ltd. Partnership v. Hooks* because otherwise it would have incurred contractual liability. The supreme court explained that the *Hooks* observation about duress appeared to be *dicta* and, in any event, the mineral lessee was fully aware of the problem over the overlapping pooled interests. The economic consequences of *its own* "obvious error" was not "duress" making the payments involuntary.

The court quoted with approval *Howell v. Union Producing Co*., 392 F.2d 95, 115 (5th Cir. 1968):

> [The lessee] unfortunately has agreed to pay royalties two ways. Our conscience, though aroused, is relieved by the recognition that [the lessee] was the scrivener, and lucidity was in its hands and with its pen. While it may be unusual to have double royalty agreements, contractual conformity to the usual is not a judicial responsibility.[2] *To argue that we must enforce only reasonable contracts or contracts which reasonable men enter into, mistakes our function. We can and do enforce unreasonable contracts if they be clear*. Unreasonable men make reasonable contracts and reasonable men may make unreasonable contracts.

(Emphasis added).

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2 This theme also implicitly underlies the reasoning in *Winske v.Ealy* below.

Issues and Evidence Presented Before a Summary Judgment is Finally Decided Are Timely for Purposes of Rule 166a (c).

The opinion is also instructive on summary judgment procedure and the ratification defense. Procedurally, the mineral interest owner pleaded ratification as a defense and urged it as a ground for avoiding summary judgment, but did not present its supporting evidence until it moved for reconsideration of an adverse summary judgment ruling as required under rule 166a(c), and the seminal summary judgment decisions in *Clear Creek* and *Kelley-Coppedge*. The court refused to find that this series of events operated as a waiver because both the allegation and the supporting evidence were presented before a *final* adjudication, even though the evidence was not presented in the initial summary judgment response.

Notice of a Change Without Specification of What the Change Is Suffices to Establish Ratification of That Change.

With regard to the merits of the ratification claim, the court ruled that notice of a change to the pooling agreement was provided when the parties to that agreement learned the amendment occurred, even though they did not learn of the particulars of the amendment. Subsequent acceptance of royalties without challenging the amendment was sufficient to establish ratification. The amended petition against the mineral owners set out the amendment to the pooling agreement. Those who joined in that amended petition had notice of the amendment to the pooling agreement and therefore ratified that amendment by later accepting royalty payments without complaint or challenge.

***Oil & Gas*: The Meaning Expressed by the Language Used in Mineral Deeds Takes Precedence Over Industry Expectations From the Use of Certain Phrases or Clauses.**

> *Winske v. Ealy* , a 5:4 decision, involved the proper interpretation of a mineral interest deed and whether its non-participating royalty interest[3] only burdened the grantees' interests, or whether it also applied to the grantor's reserved interests. At the outset, the majority opinion by Justice Brown announces that the court is following the recent trend of "cast[ing] off rigid, mechanical rules of deed construction."
>
> We have warned against quick resort to these default or arbitrary rules. And we do so again today by reaffirming the paramount *importance of ascertaining and effectuating the parties' intent*. We determine that intent by conducting a careful and detailed examination of a deed in its entirety, rather than applying some default rule that appears nowhere in the deed's text.

(Emphasis added).
Mineral Deed Exceptions and Reservations

The relevant transactions were:

1. Winske acquired the mineral interest from the original sellers, who reserved a collective ¼ non-participating royalty interest.

2. Winske later conveyed the interest by warranty deed to the Ealys. The Winske-Ealy mineral deed reserved to Winske: an undivided 3/8ths of all oil, gas, and other minerals … that may be produced…. If the mineral estate is subject to existing production or … lease, the … benefits … are allocated in proportion to ownership in the mineral estate.

   The mineral deed also provided for the "*exception*" from the conveyance of an: [u]ndivided [1/4th] interest in all of the oil, gas and other minerals in and under the herein described property, reserved by [the

[3] A non-participating royalty interest is a free royalty on gross production with no participation in the execution of, the bonus payable for, or the delay rentals that accrue under estate owner's mineral lease.

grantors] for a term of twenty-five (25) years … together with all rights, express or implied, in and to the property ….

Grantor, … *subject to the Reservations from Conveyance and the Exceptions to Conveyance and Warranty*, grants, sells, and conveys to Grantee the Property…. Grantor … warrant[s] and [will] forever defend all and singular the Property to Grantee...except as to the Reservations from Conveyance and the Exceptions to Conveyance and Warranty.

(Emphasis added).

3. The Ealys and Wenskes entered into oil-and-gas leases that provided for a 1/4th royalty on production. The dispute was over whether the original seller's 1/4th non-participating royalty interest should have been paid out of *both* the Wenskes' and the Ealys' royalties, or out of the Ealys' royalties *alone*. Bass*'s Limitation of the "Subject*

To" Clause to the Scope of the Warranty and Not the Conveyance Was Based on Grammatical Context, Not the Invariable Effect of the Words "Subject To"

The majority began its analysis by looking to the objective intent of the parties as expressed in the instrument while rejecting "mechanical" rules of construction giving certain clauses priority over others or requiring "magic words" to be effective. The majority first considered the effect of the "subject to" clause and *Bass v. Harper*. In *Bass*, the grantor conveyed a one-half interest in the minerals, "subject to" a royalty interest that had been previously reserved by third parties. The grantee claimed that the grantor intended to convey one-half of the mineral interests that he owned, not an absolute one-half interest in the entire mineral estate. The court refused to read into the deed the unstated limitation of the conveyance to the interest that the grantor owned. Based on location of the "subject to" clause, it considered the exception to be connected directly to the granting clause.

However, the reasoning in *Bass* was deemed inapplicable to the way the Winske-Ealy mineral deed was worded. The majority commented that "[s]ince *Bass*, our rules for deed construction have moved even more decisively toward (1) a focus on the intent of the parties, expressed by the language within the four corners of the deed, and (2) harmonizing all parts of an instrument [as a whole], even if particular parts appear contradictory or inconsistent." Indeed, the majority took the court of appeals to task for applying a "default" rule that "[o]rdinarily the royalty interest . . . would be carved proportionately from the two mineral ownerships." Instead, the court of appeals should have considered the intent of the parties based on the way the deed was written.

Plain Meaning Takes Priority over Industry Expectations Based on Traditional Purpose for Using a Particular Phrase or Clause.

The majority explained that "subject to" means "subordinate to, subservient to or limited by." The deed described the interest out of which the Ealys fractional interest was to be conveyed as being "subject to" the original seller's non-participating royalty interest. In doing so, the parties clearly manifested the intent that both the Wenskes' and the Ealys' interests would be burdened proportionately by the original seller's non-participating royalty.

Historically, scriveners would use the "subject to" clause to limit the grantor's liability under the deed's warranty, not the scope of interests conveyed. But, according to the majority, reading the "subject to" clause to have no other effect regardless of what the plain language says is an impermissible "mechanical" interpretation.

Without explicitly saying so, the majority appears to be notifying drafters that it will not read industry expectations to ascertain the parties intent from the use of certain clauses when that intent is not consistent with the effect of the language used. The majority was careful to say that its decision neither "vitiate[s] the established background principles of oil-and-gas law nor … open[s] for debate the meaning of clearly defined terms…." But they must be used in a way that is consistent with a plain reading of the language used in the instrument.

The dissenters, led by Justice Boyd, take the view that the plain language of the deed only makes the interest conveyed "subject to" the original seller's non-participating royalty. They first attack the majority's failure to

clearly specify whether it was the grantor's interest or the interest conveyed that was "subject to" the pre-existing royalty. According to the dissenters, for several grammatical reasons the deed was clear that it was the *conveyance* that was made "subject to."

The greater schism between the majority and the dissent is over the role of prior interpretation and the value of the ability to rely on those interpretations and the uncertainty that a departure from these interpretations represent. The dissent carefully reviews a litany of prior cases concerning the effect of reservations and exceptions on the conveyance of fractional interests of fractional interests to establish the proposition that the court should first "see what interest the deed granted and then explain[] that an interest that is reserved or excepted is "excluded from the grant…'"

In this writer's view, the cautious drafter must be aware of the conventional wisdom about the purpose of certain terms and clauses. But familiarity with the industry *lingua franca* is not enough. These clauses and phrases must be written in a way that their grammatical usage is consistent with those expectations. As the 5:4 decision reflects, this is an area where the assumption of consistency may not be entirely safe. Divorcing conventional professional understanding from the plain-meaning interpretation is likely to be a long and inconsistent process as the supreme court resolves the tension between the interpretive approaches of the majority and dissent.