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***Contract Formation*: When parties agree not to be bound until they sign a definitive agreement, exchanged e-mails reflecting the terms of that agreement are not themselves a binding contract.**

***Waiver*: Deviations from other specified negotiating procedures was no evidence of the intentional relinquishment of the no-obligation clause's requirements when both parties referred to and proceeded in accordance with those requirements.**

Once again, "freedom of contract" takes center stage in the resolution of a dispute whether the parties reached an enforceable agreement for the sale of $230 million worth of oil and gas interests through an email exchange. In *Chalker Energy Partners III, LLC v. Le Norman Operating LLC*, the court acknowledges that parties may agree to a specific manner of acceptance necessary to form a contractual obligation and, when they do, e-mail correspondence that does not satisfy the agreed upon form of acceptance does not result in a binding contract.

The parties specified there would be no deal until there was a signed purchase and sale agreement.

In *Chalker*, to bid on the certain oil and gas interests being offered for sale obliged the potential buyer had to sign a confidentiality agreement. That agreement contained a no-obligation clause that stated "unless and until a *definitive agreement* has been executed and delivered, no [other] contract or agreement providing for a transaction between the Parties shall be deemed to exist … by virtue of this or any written or oral expression thereof." (Emphasis added). The confidentiality agreement further stipulated "the term 'definitive agreement' does not include an executed letter of intent or any other preliminary written agreement or offer, unless specifically so designated in writing and executed by both Parties." Once a prospective bidder signed the confidentiality agreement, they were supplied with bidding procedures and access to data about the offered assets.

When the first round of bidding didn't work out, the parties conducted a second round of bidding and made the winning bid binding only if there was a written PSA.

A definitive agreement to buy 100% of the offered assets was never reached. Sellers offered to sell 67% of these assets instead. One of the bidders on the 100% asset offer, Le Norman, submitted an e-mail entitled "Re: Counter-Proposal" offering to buy the 67% for $230 million. That email also listed other terms without reference to the bidding procedures. The sellers approved the offer before Le Norman's acceptance deadline. The sellers' representative responded by email telling Le Norman the sellers were "on board … subject to a mutually agreeable PSA" – i.e., purchase and sale agreement – and that sellers would be preparing a draft of such an agreement.

Before seller and the high bidder signed the PSA, seller accepted an offer from another bidder and executed a PSA.

A competing bidder, Jones Energy, emailed one of the sellers and acknowledged losing the bidding on the 67%. Two days later, however, Jones Energy floated a new offer for the 67%. Sellers agreed to accept. Five days later, sellers and Jones Energy executed a PSA like the no-obligation clause called for. At that time, Le Norman was still haggling with sellers over the wording of a PSA for its previous bid on the 67%.

Trial court renders take-nothing summary judgment because the high bidder and seller had not signed a PSA and, without it, seller had no obligation to sell to the high bidder.

When it found out sellers struck a deal with Jones, Le Norman sued the sellers for breach of contract. That suit came to an abrupt halt when the trial court rendered a take-nothing summary judgment. It reasoned the terms of the no-obligation clause for the effort to sell the 100% interest also applied to the later attempt to sell 67%. The evidence conclusively established the parties intended no binding contract under those agreements until they executed a written PSA. Sellers and Le Norman had not signed such an agreement before sellers signed the PSA with Jones. The trial court ruled the sellers were under no obligation to sell to Le Norman even though they communicated acceptance of Le Norman's offer.[1]

A new wrinkle on old problem: Is a deal a deal when the parties agree, or when they document their agreement?

Chief Justice Hecht's unanimous opinion proclaims that it addresses new circumstances presented by email technology. However, the central question is neither novel nor complicated: had the parties agreed to a particular form of acceptance before an agreement would be binding? In other words, was the contract formed when they manifested their assent to its essential terms – in this case, through the email exchange – or was there no agreement until the parties signed the written documentation of that agreement as required under the no-obligation clause?

The wording of the bidding terms and confidentiality agreement did more than raise a fact issue. They conclusively established there was no binding obligation unless and until there was a signed PSA.

In the summary judgment context, the issue was whether the circumstances conclusively established that a signed document was essential to an enforceable agreement or merely raised a fact issue about what the parties intended concerning formation of such an agreement. The opinion recognized that phrases like "subject to legal documentation" have been held to merely raise a fact issue about when the parties intended for the agreement to be binding. But, the language of the no-obligation clause requiring a "definitive agreement" to be executed and delivered, coupled with the email that seller's acceptance was "subject to a mutually agreeable PSA," left no doubt for a trier of fact to resolve. It established that the parties had agreed precisely that a "definitive agreement" was a condition precedent to the formation of a contract of sale, though the confidentiality agreement and bidding procedures did not define what was a "definitive agreement." It only indicated that it was more than a "letter of intent or any other preliminary written agreement or offer."

The plain meaning of "definitive agreement" and the parties' conduct showed that they mutually agreed that a final signed PSA was a condition to the formation of a sales contract.

The court predictably resorted to its well-thumbed copy of *Black's Law Dictionary* from which it determined: (1) a "definitive" agreement is one that provides a "final solution or … end" that is "authoritative and apparently exhaustive" and (2) a "preliminary agreement" is one where the parties "allocate their contributions to an undertaking but do not specify all the important terms of the deal." In this case, the emails themselves "suggested" that a written and signed PSA was necessary to satisfy the "definitive agreement" requirement. The later unsuccessful attempts of Le Norman and sellers to negotiate a PSA confirmed this accurately reflected the parties' objective intent. Le Norman had continued to haggle over the PSA's terms so that no PSA was ever "executed and delivered" before the PSA with Jones was signed. And a signed agreement was necessary to formation of a contract under the no-obligation clause.

The parties are free to agree when a contract is formed and, in this case, the evidence conclusively established they agreed there would be no binding obligation until the PSA was signed.

The emails between sellers and Le Norman identified the assets to be sold, the price, closing date and "other key provisions." But for the previous agreement about how and when a contractual obligation arose, these might have been sufficient to state the essential terms necessary for a binding sales contract. However, the email correspondence

[1] The court found it unnecessary to address sellers' argument there was no enforceable contract for want of an agreement to conduct business electronically under the Texas Uniform Electronic Transactions Act in Business & Commerce Code chapter 322.

did not state the terms of a "definitive" agreement because they "le[ft] much to the imagination" about the particulars for escrow, non-compete, and joint operating agreements.

To be sure, individuals among the sellers sent messages that they were "committed" to sell or were selling certain assets to Le Norman. But the court ruled these messaged were no evidence from which the court could "create a fact issue [about contract formation] in light of the … No Obligation Clause." If such isolated observations by individual constituents of a sellers' collective could undermine the "No Obligation Clause" by being deemed to raise a fact question about when the agreement was to come into being, such clauses would rarely be definitive. Enter the "freedom of contract" argument. The opinion says the "No Obligation Clause" was intended to let the parties freely negotiate their agreement by exchanging proposals "without fear of being bound to a contract." The court concluded that's exactly what the sellers and the participating bidders agreed to do in this case. That's what they were trying to do.

Procedural deviations from the bidding terms in the confidentiality agreement were no evidence of waiver of the no obligation clause when the parties own emails referred to the necessity of the execution of a PSA.

As a last resort, Le Norman tried to save its right to buy the 67% by arguing there was a fact issue whether sellers waived that condition in their exchange of emails communicating Le Norman's $230 million offer and seller's recommendation to "move forward" with the sale of the 67%. The pivotal issue on this point was whether, as the trial court had ruled, the no-obligation clause for the attempted sale of the 100% applied to the later effort to sell the 67%.

Le Norman's email communicating the $230 million offer said that "it could "no longer pursue the . . . transaction as altered by the Sellers." Le Norman insisted this statement at least raised a fact issue whether the original bidding procedures of which the no obligation clause was a part continued to apply. However, Le Norman also characterized it offer a "Counter Proposal" from which the court inferred that it was a continuation of earlier efforts to negotiate a sale and that the terms of the no obligation clause continued to apply thanks to the proviso that the overarching confidentiality agreement governed negotiations even if they continued beyond the stated sales deadline. The court recognized that the parties had varied from the terms of their initial email exchange concerning Le Norman's $230 million offer.

These deviations were declared, however, to be no evidence of the intentional relinquishment of a known right that was necessary to waive the right to "definitive agreement" before incurring any contractual duty. Le Norman's own email declarations that execution of the PSA was part of the "base deal" and the sellers' statement that they were "on board … subject to a mutually agreeable PSA" were consistent with the no obligation clause and were no evidence of a waiver of the right to an executed PSA.

***Ad Valorem Taxation*: The tax exemption for goods held in a free trade zone continues until the free trade zone is formally deactivated by Customs, even if the free trade zone is no longer operated by the entity originally approved to act as operator despite federal regulations requiring approval of the new operator.**

To encourage U. S. manufacturing by lowering the cost of finished goods, the federal Foreign-Trade Zones Act of 1934 exempts imported goods from state and local *ad valorem* taxes while held within an *activated* foreign trade zone (FTZ). FTZs are created by a Board which approves a grantee to establish, operate, and maintain the zone. The grantee then designates an operator for Customs to approve. Once the operator is approved, Customs activates the FTZ, after which the *ad valorem* tax exemption applies. Until the FTZ is activated, there is no exemption.

In *PRSI Trading, LLC v. Harris County*, the Port of Houston Authority was the grantee. The operator it originally appointed was a corporation involved in refining. The operator was acquired by another entity in 2006 which continued refinery operations.

When a different entity takes over as operator, federal regulations require the grantee to appoint a new operator which, in turn, must apply for approval of a new FTZ activation. In this case, however, the grantee, the Port, could not designate the successor as the FTZ's operator because Harris County would only "permit" the designation if the new operator agreed to forego the tax exemption.

For years, Customs approved the successor's requests to admit and process goods in the FTZ and granted extensions of time to designate it as the new operator. After seven years, however, enough was enough. Customs decided the FTZ no longer existed and could not be resurrected without a new approval and activation, which Harris County blocked. The Port asked the FTZ be deactivated. The successor removed its inventory and Harris County's appraisal district stopped recognizing the tax exemption.

Harris County sued for a determination that the successor had not been entitled to the *ad valorem* tax exemption between its acquisition of the original operator in 2006 and the 2013 decision deactivating the FTZ. Thus, the issue before the court was whether the FTZ and its tax exemption ended automatically when the successor took over for the approved operator in 2006 or the FTZ continued until it was declared inactive by Customs.

In a unanimous opinion by Chief Justice Hecht, the court ruled that the FTZ and the tax exemption continued until the 2013 formal deactivation notwithstanding the change in the corporate operator. The opinion pointed to the ongoing actions of Customs to treat the FTZ as extant by approving repeated extension requests for designation of the new operator. However, course of conduct was not the dispositive factor. Instead, the opinion pointed to the procedures for deactivation specified in the manual governing FTZ operation. A section in that manual provided specifically for the continued responsibility of the "existing operator" until the FTZ is deactivated.

The opinion reasons that it was not up to the court to read into the regulatory scheme a method of "implied" deactivation once the qualifying criteria were no longer satisfied when the regulatory scheme itself provided an explicit deactivation procedure. What the opinion does not explain, however, is how a *different* entity that was not the same entity as the "existing operator" could be deemed responsible for anything when it no longer existed.

The opinion's reasoning either "reads into" the regulations that zombie operating entities can continue to be recognized or that a *de facto* takeover of operator status is enough to make the successor the "existing operator." No matter how one characterizes its theoretical approach, it appears the court was comforted by continuing liability of the surety on the original operator's bond until the FTZ is deactivated or the new operator is approved.

***Easements*: Easements that confer an area on the basis of reasonable and necessary usage for a stated purpose are valid and do not limit the grantee to using areas that had been previously used when that purpose anticipated the need for future expansion.**

***Contract Interpretation – Extrinsic Evidence*: When an easement is not ambiguous, extrinsic evidence of historic property use for the easement's purposes cannot be considered to limit the geographic scope of an agreement for a "reasonable and necessary" area.**

In 1949, SWEPCO's predecessor acquired a power line easement of unspecified width on which it constructed a transmission line suspended on wooden "telephone" poles. The geographic scope of the easement was defined as what was reasonable and necessary for its use. The plaintiff landowners later acquired the servient properties. SWEPCO then proposed modernizing the transmission line with steel poles. As part of the project, it offered additional compensation if the landowner would agree to new easement terms that allowed a fixed easement 100 feet wide. The soon-to-be plaintiffs demurred with a thanks-but-no-thanks to amending the terms of the 1949 easement.

They permitted SWEPCO to use that easement to upgrade the transmission line, but then sought declaratory judgment that the width of the 1949 easement should be fixed at 30 feet with the steel poles at its center. The rationale for the proposed width was that SWEPCO had only used that much surface for the construction and maintenance of the transmission line.

A suit for declaratory judgment is sufficiently ripe if the relief sought would resolve a present disagreement between the parties.

The threshold issue in *Southwestern Electric Power Co. v. Lynch, et al.* was presented by SWEPCO's motion to dismiss for want of jurisdiction on grounds that the declaratory judgment suit was based on the landowner's concern that SWEPCO would in the future assert a right to a broader easement swath than it had historically. In an 8-0 opinion by Justice Green,[2] the court reiterated that declaratory judgment actions, like any suit, had to meet the ripeness requirement. It questioned the rationale of cases suggesting that "ripening seeds of a controversy" are enough to make the case justiciable. Instead, the test for sufficient ripeness in declaratory judgment suits is whether the declaration requested would resolve a present controversy. The "present controversy" in this case was the disagreement over the specific width of the easement available to SWEPCO. The landowners sought to restrict the easement's width to a specific width of thirty feet. That was enough to make the case a live, justiciable controversy over which the courts could exercise jurisdiction.

It seems to this writer that the opinion's reasoning about justiciability and ripeness doesn't really explain how the court arrived at its ruling. If a present disagreement is enough to satisfy the justiciability requirement, why isn't the act of seeking declaratory relief alone a manifestation of a present disagreement? Obviously, the court is going to require more than that, but it remains uncertain what the nature of *that* "more" is.[3]

Extrinsic evidence about historical usage could not be considered to limit what would otherwise be a reasonable and necessary width to accomplish the stated purpose of the easement.

As made clear in the June 28, 2019 decision in *Barrow-Shaver Resources Co. v. Carrizo Oil & Gas, Inc*., surrounding circumstances and custom and usage cannot be considered unless the instrument is ambiguous or lacking in necessary specifics that the parties later defined through their own usage. In this case, the dispute on the merits concerned the precise meaning of the grant of an easement of a "reasonable and necessary" area along the route of the transmission line. The trial court considered evidence that SWEPCO had historically limited its usage to an area fifteen feet on either side of the transmission line.

The landowners argued that this historical usage operated to set the width of the legally enforceable easement to a width of 30 feet. The opinion considered this evidence as extrinsic evidence that could not be considered. Just because the easement did not specify a specific width did not make it ambiguous or indefinite. It just meant that the parties defined their rights in terms that were flexible according to what was reasonable and necessary to the easement's specified purpose, which they were perfectly at liberty to do.

In *Houston Pipe Line Co. v. Dwyer*, 374 S.W.2d 662, 666 (Tex. 1964), the court ruled that "once the location of [such a non-specific] easement is selected by the grantee, its rights then become fixed and certain" so that the grantee could not double the size of the pipeline for which the easement existed. The court's *SWEPCO* opinion devotes substantial

[2] Justice Bland did not participate in this decision.

[3] Unexplained results like this make it difficult for practitioners to distinguish principled decisions from mere arbitrary results. Such outcomes carry the possible, if unintended, basis for doubting about the outcome's impartiality.

discussion to “distinguish” *Dwyer* based on the purported limited purpose from SWEPCO’s easement by pointing to the fact that the latter specifically anticipated using additional wires and the necessary towers, poles and other infrastructure.

The court has previously recognized that designation of a specific width is not necessary to a valid general easement. By anticipating that conditions in the future might require an increase, the “lack of a specified width in an easement does not mandate the admission of extrinsic evidence to prescribe a width. ”The opinion explained that “doing so obviates the flexibility that general easements afford the parties who bargained for the terms of an express general easement.” Parties are free to so structure their easements and subsequent purchasers with notice are bound to them. “If the easement’s terms are ascertainable and can be given legal effect, courts will not supplant the easement’s express terms with additional terms nor consult extrinsic evidence.” Accordingly, SWEPCO’s easement was not limited to the area it used previously for that purpose. The easement was limited only by a reasonable and necessary area for the easement’s stated purposes.