

NO. 09-0270

IN THE SUPREME COURT OF TEXAS

XTO ENERGY INC.,

Petitioner,

vs.

SMITH PRODUCTION INC.,

Respondent.

RESPONDENT SMITH PRODUCTION INC.'S BRIEF ON THE MERITS

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RESPONSE ISSUES PRESENTED

ISSUE ONE

The court of appeals correctly held that Article VI.B of the JOAs unambiguously permits each non-operating working interest owner only one election about whether to participate in proposed drilling operations—regardless of whether a subsequent election is attempted within the 30-day notice period or not.

ISSUE TWO

The court of appeals correctly held that XTO failed to raise a fact issue about custom and usage on the meaning of Article VI.B in the oil and gas industry because—even assuming the law should be changed to permit such evidence to construe ordinary terms in an unambiguous contract—XTO’s summary judgment evidence fell far short of the degree of general understanding in the industry necessary to establish custom and usage under well-established Texas law.

ISSUE THREE

XTO’s contrary interpretation is unreasonable as a matter of law because it adds new language to Article VI.B, is internally inconsistent, and would ordinarily create a disputed issue of material fact whenever a non-operating working interest owner attempts to change its election, undercutting the primary advantage of an industry-wide form contract like the JOAs and exposing operators to the risk of double liability.

STATEMENT OF THE CASE

XTO's Statement of the Case is generally accurate, except insofar as it asserts that "[t]he parties filed cross motions for summary judgment." (XTO Br. ix.) Smith sought a final summary judgment, but XTO filed only a motion for *partial* summary judgment, not a final judgment. *See XTO Energy Inc. v. Smith*, 282 S.W.3d 672, 675 n.3 (Tex. App.—Houston [14th Dist.] 2009, pet. filed); *accord id.* at 688 n.9 (Guzman, J., dissenting). (*See* 1 CR 50.)

The court of appeals' opinion is now reported at 282 S.W.3d 672.

STATEMENT OF FACTS

XTO's version of the facts is generally correct, but contains various extraneous discussions that need not concern the Court. Many of XTO's facts are simply irrelevant and not "pertinent to the issues or points presented" in this appeal. TEX. R. APP. P. 55.2(g). To the extent they are relevant, they need little explication. Since XTO appeals from a summary judgment in Smith's favor, XTO's version of any disputed fact must be accepted as true for purposes of this appeal. *See Park Place Hosp. v. Estate of Milo*, 909 S.W.2d 508, 510 (Tex. 1995) ("In reviewing a summary judgment, we must accept as true evidence favoring the nonmovant, indulging every reasonable inference and resolving all doubts in the nonmovant's favor.").

For example, in Sections B.3, C, and D, XTO belabors its assertion that Chevron's initial election was a mistake. (XTO Br. 4-8.) But the reasons for Chevron's initial election and its subsequent, attempted change of election do not matter under *either* party's theory of how the joint operating agreements (JOAs) should be construed.

Similarly, in Section G, entitled "Smith And The Other Parties Did Not Materially Change Their Positions Prior To Chevron Changing Its Elections" (*id.* at 10-13), XTO marshals its evidence that the other non-operating working interest owners would have sustained no harm by reversing their decision to assume Chevron's proportionate burden of expenses. XTO's argument ignores the possibility that regardless of how soon the change occurred, Moran, CNR, and Franke might have objected to Chevron taking a part of their newly-acquired interests, and might have subsequently brought their own lawsuit against Smith for allowing Chevron to make a

second election. But more importantly, this “material change” issue is entirely irrelevant under the only reasonable reading of the JOAs. Even if the Court were to accept XTO’s interpretation of the JOAs, however, the factfinder on remand—not the Court—must evaluate the evidence of the other non-operating working interest owners’ material change. (*See id.* at 39-40 (requesting remand for determination of material change issue if Court accepts XTO’s interpretation).)

XTO’s Statement of Facts is occasionally selective as well. For example, as evidence that its claim for relief was vigorously preserved, XTO points to Chevron’s July 15, 2004 letter, which stated that Chevron “was prepared to participate in drilling the Wells and wanted to be billed for its share of the costs of the Wells according to the terms of the JOAs.” (*Id.* at 8 (citing 2 CR 383).) But XTO neglects to mention that Chevron did not bother to tender a check for its share, even though the “authority for expenditure” (AFE) forms that Chevron signed and sent to Smith expressly required remittance of a specific amount due. (2 CR 473-76.) More significantly, neither Chevron nor XTO made further complaints or took any legal action whatsoever for nearly six months, until XTO filed this lawsuit. (1 CR 2.) By then, it was public knowledge that all four wells were a commercial success and that Chevron’s experts were completely off the mark in deeming them a bad investment. (4 CR 776.)

In summary, while XTO’s Statement of Facts does no particular harm, it falls short of being a statement “without argument” of “the facts pertinent to the issues or points presented” under the applicable standard of review. TEX. R. APP. P. 55.2(g). These same vices afflict XTO’s recitation of “Summary Judgment proof” in its Summary

of the Argument. (See XTO Br. 13-15, especially nos. 4, 5, 8 & 10.)

SUMMARY OF THE ARGUMENT

The court of appeals correctly construed the disputed provisions of Article VI.B of the JOAs, based on both the plain language and the intent of the JOAs' drafter, the American Association of Professional Landmen, an organization that represents operators and non-operators alike. The court's holding that Article VI.B of the JOAs permits non-operating working interest owners only one election about whether to participate in proposed operations is a bright-line, easy-to-apply rule by which all parties can safely and efficiently structure their conduct in subsequent drilling operations.

In contrast, XTO's proffered construction is not primarily based on the text of the JOAs, but rather on the conclusory affidavit testimony of a retained expert witness. Historically, custom and usage testimony has not been admissible in this State to interpret unambiguous contracts. Even if such testimony is now sometimes admissible under Texas law, it should only be allowed to explain words or phrases that are being used in a specialized context, not ordinary words like "elect" and "notice" that are employed in their ordinary sense. XTO makes no attempt to show that either term has a secret or specialized meaning in the oil patch; its proof is confined to a few generalized assertions that certain entities behaved in certain ways when faced with past situations that may or may not be substantially similar to the facts here.

Moreover, even if such anecdotal evidence of past behavior were admissible to interpret an unambiguous contract, such party-sponsored testimony would be much more appropriate in construing negotiated language than the provisions of a

widely-used, well-established form contract such as the JOAs. Users of form contracts would benefit far more often from a settled interpretation of standardized provisions than they would from a chance to prove up some idiosyncratic meaning in a particular dispute by means of protracted, expensive litigation.

Furthermore, even if Texas law were to permit expert evidence in construing any contract, whether ambiguous or not and whether involving specialized terms or not, the law governing the quality of proof necessary for custom and usage is well established and must still be met. The court of appeals did not even reach the issue of whether XTO's expert evidence was admissible in the first place because the court correctly held that, as a matter of law, XTO's affidavits fell far short of constituting any evidence that its preferred interpretation was so widespread or well known that it could fairly be imputed to the parties in this case. XTO brings forth no authorities to suggest that the minimum requirements to show custom and usage of a particular word or phrase have been or should be relaxed under Texas law. Instead, it seeks to confuse the issue by conflating the requirements for *when* such proof can be admitted with *what* such proof must show to be probative.

Finally, even if this Court were to accept XTO's morsel of paid testimony as both admissible and probative on the meaning of the JOAs, the Court should still reject XTO's interpretation as unreasonable as a matter of law because of the havoc it would wreak on the oil and gas industry. If adopted, XTO's nebulous "absence-of-harm" standard would create a fact issue for trial anytime a non-operating working interest owner attempted to change its election. This "let the jury sort it out" approach would

probably benefit the legal industry and might even conceivably benefit XTO in this particular case, but it is hard to see who else would profit from it. Without doubt, it would add confusion, delay, and expense to the already risky and difficult business of oil and gas development, exposing operators to double liability and inconsistent results. Neither Chevron nor Smith thought they were “buying a jury trial” when they chose the industry’s dominant form agreement to govern their ongoing relationship. The AAPL expressly rejected a similar argument in its amicus brief in *Nearburg v. Yates Petroleum Corp.*, 943 P.2d 560 (N.M. Ct. App. 1997), and no doubt never intended such an anomalous result here. No societal good can come from imposing a trial on the merits on the parties to the JOAs or their successors because of this dispute.

ARGUMENT

I. The court of appeals correctly held that Article VI.B of the JOAs unambiguously permits each non-operating working interest owner only one election about whether to participate in proposed drilling operations—regardless of whether a subsequent election is attempted within the 30-day notice period or not.

Under Article VI.B of the JOAs, an operator is required to advise each non-operating working interest owner of its intent to drill subsequent well(s), and each owner may participate in the proposed well(s) by timely notifying the operator of its election to do so:

Proposed Operations: Should any party hereto desire to drill any well on the Contract Area other than [the initial wells], . . . the party desiring to drill . . . such a well shall give the other parties written notice of the proposed operation, specifying the work to be performed, the location, proposed depth, objective formation and the estimated cost of the operation. The parties receiving such a notice shall have thirty (30) days

after receipt of the notice within which to notify the party wishing to do the work whether they elect to participate in the cost of the proposed operation.

(3 CR 571.) Under both the plain language of this provision and the clear purpose it seeks to achieve, only one election is allowed. Accordingly, the court of appeals' opinion and judgment were correct, and this Court should deny review.

As a matter of simple grammar, Article VI.B speaks of one election, not multiple ones. To "elect" is "[t]o make deliberate choice of (a course of action, an opinion, etc.) in preference to an alternative." 1 THE COMPACT EDITION OF THE OXFORD ENGLISH DICTIONARY 841 (1971). To "notify" is "[t]o make known, publish, proclaim; to initiate, give notice of, announce." *Id.* at 1948.

Thus, when Article VI.B gave XTO's predecessor Chevron "thirty (30) days after receipt of the notice [from the operator] within which to notify the party wishing to do the work whether they elect to participate in the cost of the proposed operation," (3 CR 571), it set a deadline within which Chevron could take a particular action. *See Valence Operating Co. v. Dorsett*, 164 S.W.3d 656, 662 (Tex. 2005) (observing that under Article VI.B of an earlier but substantially similar version of AAPL Form 610 JOA, "the thirty-day notice period sets a deadline for [non-operating working interest owners] to decide whether to participate in proposed operations"). That election is a singular event, not a month-long drama. *See id.* at 663 (discussing "the working interest owner's right to thirty days notice before being required to make a *decision*") (emphasis added); John R. Reeves & J. Matthew Thompson, *The Development of the Model Form Operating Agreement: An Interpretative Accounting*, 54 OKLA. L. REV. 211,

246 (2001) (stating that “each version of the AAPL Form 610 Model Form Operating Agreement provides that a party’s receipt of written notice triggers the time period for a party to make *an election* as to a proposed subsequent operation”) (emphasis added).

Chevron made its choice under Article VI.B on June 17, when it notified Smith that it did not wish to participate. (3 CR 708-12.) The court of appeals correctly held that Chevron’s attempt to rescind that choice and make a second election on June 24 was not valid under the plain terms of the JOA.

By giving effect to Article VI.B as written, the court of appeals’ decision was consistent with the views that have been publicly expressed by the American Association of Professional Landmen (AAPL), which drafted the very language at issue. In an amicus brief filed in *Nearburg v. Yates Petroleum Corp.*, 943 P.2d 560 (N.M. Ct. App. 1997), the AAPL could not have been clearer in explaining that Article VI.B contemplates one election, and one election only:

The AAPL Model Form Operating Agreement contains no provision allowing a party to retract or change its election not to participate in the drilling of a new well. This is true regardless of whether the election is by an express declaration of nonparticipation or is the result of a failure to reply to a properly given notice.

(Br. of Amicus Curiae AAPL at 13-14 (filed in Cause No. 16,783 (N.M. Ct. App. Mar. 22, 1996)) (attached as Appendix A).)¹ The court of appeals’ interpretation is correct.

¹ Although *Nearburg* involved an owner’s attempt to change an election more than 30 days after receiving notice, *Nearburg v. Yates Petroleum Corp.*, 943 P.2d 560, 569-70 (N.M. Ct. App. 1997), nothing in the AAPL’s amicus brief indicates that its interpretation of the JOA as precluding a change in election was so limited. While XTO repeatedly emphasizes this factual distinction between *Nearburg* and the instant case (XTO Br. 16, 23, 24), it makes no attempt to

II. The court of appeals correctly held that XTO did not prove that custom and usage permits a non-operating working interest owner to change its election under Article VI.B.

The core of XTO’s argument is that expert “trade usage evidence is admissible to supply the omitted terms in Article VI.B.1,” (XTO Br. 37), and that it marshaled sufficient such evidence to “show[] that parties to the [JOAs] can change their election during the 30-day notice period—provided that the other parties have not materially changed their positions in reliance on the initial election.” (*Id.* at 15.) Both of these contentions are incorrect.

A. This Court should not grant review to address an issue the court of appeals did not reach and change the law governing the admissibility of custom and usage to explain ordinary terms in an unambiguous form contract.

XTO does not dispute that “election” and “notice” are common terms, used in Article VI.B in their common parlance. Under long-settled Texas law, custom and usage testimony has not been admissible to explain such common terms in the absence of ambiguity. *See, e.g., Miller v. Gray*, 149 S.W.2d 582, 583 (Tex. 1941) (“[E]vidence of custom is admissible only to explain an ambiguous contract or to add to it an element not in contravention of its terms; but such evidence is never admissible to contradict the plain unambiguous covenants and agreements expressed in the contract itself.”); *Tex. Gas Exploration Corp. v. Broughton Offshore Ltd. II*, 790 S.W.2d 781, 785 (Tex. App.—Houston [14th Dist.] 1990, no writ) (“Custom and usage of trade are not relevant where the contract language is, like the language before this court, clear and unambiguous.”

challenge the AAPL’s underlying conclusion in its amicus brief about the very issue in dispute here.

citing Miller v. Gray, 149 S.W.2d 582 (Tex. 1941)); *cf. C & C Partners v. Sun Exploration & Prod. Co.*, 783 S.W.2d 707, 713-15 (Tex. App.—Dallas 1989, writ denied) (refusing to consider testimony that industry practice required consent to participate in drilling operations to be given by written AFE because JOA provision was unambiguous).²

Despite this law—and despite the fact that the court of appeals did not even reach the issue of the admissibility *vel non* of XTO’s custom and usage evidence—XTO urges the Court to grant review to adopt the alleged “modern trend” of “recogniz[ing] usages as an inherent part of agreements associated with an industry,” admissible even where the agreement is unambiguous. (XTO Br. 33-34.) As evidence of this modern trend, XTO cites one case—*Holmes v. Beatty*, 290 S.W.3d 852 (Tex. 2009)—which this Court handed down after the court of appeals issued its opinion in this case.

In *Holmes*, the Court used “[p]recedent, trade usage, and seminal treatises” to construe the designation “JT TEN” in a married couple’s brokerage account agreement as creating a right of survivorship, sufficient to satisfy the Probate Code’s requirement that a right of survivorship in community property be written. 290 S.W.3d at 858-59. In holding that a prior opinion that excluded parol evidence of the depositor’s intent to construe a similar agreement was not controlling, the Court distinguished between

² To the extent that Oklahoma law, on which XTO relies, is different, Oklahoma has a statute that the Oklahoma Supreme Court has construed as requiring the consideration of custom and usage evidence. *See Oxley v. Gen. Atl. Res., Inc.*, 936 P.2d 943, 946 (Okla. 1997) (construing 15 OKLA. STAT. ANN. tit. 15, § 162 (1993)) (cited in XTO Br. at 29-30). *But cf. Pitco Prod. Co. v. Chapparral Energy, Inc.*, 63 P.3d 541, 547 n.25 (Okla. 2003) (“A finding of ambiguity must be made before the court can look at the custom of the industry to determine the parties’ obligations.”).

“outside evidence” and “reference to the common law or trade usage,” and included a “*cf.*” cite to the statement in comment b to Restatement (Second) of Contracts Section 222 that “[t]here is no requirement that an agreement be ambiguous before evidence of a usage of trade can be shown.” *Holmes*, 290 S.W.3d at 858. As discussed below, this reference in *Holmes* neither requires the admission of XTO’s expert testimony nor warrants a change in the well-established law governing custom and usage evidence.

1. *Holmes v. Beatty* does not require the admission of XTO’s expert testimony in this case.

XTO does not go so far as to suggest that the holding in *Holmes* requires the consideration of XTO’s affidavit testimony on custom and usage. And it cannot do so, because *Holmes* is thoroughly distinguishable.

As an initial matter, the Court’s construction was not based solely, or even primarily, on “usage of trade” testimony. In fact, the Court cited only statutes, case law, treatises, and other secondary sources—not expert testimony on custom and usage—as support for its construction of the phrase in question. *Holmes*, 290 S.W.3d at 857-59. In contrast, XTO relied solely on two short affidavits from a single paid expert to support its position. XTO has never cited a treatise, judicial opinion, or other neutral source to buttress its argument that Article VI.B permits a second election. Indeed, as discussed in the next section, its half-hearted textual arguments for that proposition are obviously makeweight.

Moreover, the disputed language in *Holmes* involved a legal term of art, not ordinary words used in their ordinary sense as in this case. Unlike “elect” and “notice,”

the words “JT TEN” are not found in the dictionary or employed in normal English language communication. Texas courts have long admitted evidence to explain technical terms, even in the absence of ambiguity. *See, e.g., Mescalero Energy, Inc. v. Underwriters Indem. Gen. Agency, Inc.*, 56 S.W.3d 313, 320 (Tex. App.—Houston [1st Dist.] 2001, no pet.) (in construing term “formation” in insurance policy definition of well “blowout,” stating that “a specialized industry or trade term may require extrinsic evidence of the commonly understood meaning of the term within a particular industry”); *Sivert v. Cont’l Oil Co.*, 497 S.W.2d 482, 489 (Tex. Civ. App.—San Antonio 1973, writ ref’d n.r.e.) (permitting trade usage evidence to explain technical terms “secondary recovery” and “waterflood”).

Neither of XTO’s expert Owen Barnhill’s affidavits suggests that the words “elect” and “notice” have any technical meaning here that differs from their common meaning. Instead, his testimony consists merely of anecdotes about how a handful of other parties in other, unspecified circumstances have accepted a second election. The fact that some operators may have, for unexplained reasons, chosen on past occasions to recognize a second election is not any evidence that an operator is legally *required* to accept such an election. This logical disconnect between Barnhill’s proof and his legal conclusion prevents his affidavits from being probative. *See Gammill v. Jack Williams Chevrolet, Inc.*, 972 S.W.2d 713, 726 (Tex. 1998) (“A court may conclude that there is simply too great an analytical gap between the data and the opinion proffered.” (quoting *Gen. Elec. Co. v. Joiner*, 522 U.S. 136, 146 (1997))).

2. The Court should reject XTO’s invitation to use *Holmes v. Beatty* as an opportunity to change well-established law governing the admissibility of custom and usage evidence.

While Smith has no quarrel with the result in *Holmes*, it strongly objects to XTO’s suggestion that *Holmes* justifies the adoption of an alleged “modern trend” of broadly admitting custom and usage evidence to construe unambiguous contracts. After all, *Holmes* marks only the second time that any Texas appellate court has even cited the Restatement (Second) of Contracts Section 222 for any reason,³ and indeed the courts of most states have never found occasion to cite it. In fact, outside Texas, only 28 opinions from 9 states and 13 federal appellate or trial districts have ever cited to Section 222,⁴ and

³ This Court previously cited Section 222 in a *per curiam* opinion for the unremarkable proposition that “in cases involving ‘trade usage’ evidence, . . . the meaning to which a certain term or phrase is most reasonably susceptible is the one which [is] so regularly observed in place, vocation, trade, or industry so ‘as to justify an expectation that it will be observed with respect to a particular agreement.’” *Nat’l Union Fire Ins. Co. of Pittsburgh v. CBI Indus., Inc.*, 907 S.W.2d 517, 521 n.6 (Tex. 1995) (quoting RESTATEMENT (SECOND) OF CONTRACTS § 222(1)). No Texas court of appeals opinion has ever cited this section. *But cf. Dicker v. Lomas & Nettleton Fin. Corp.*, 576 S.W.2d 672, 675 (Tex. Civ. App.—Texarkana 1978, writ ref’d n.r.e.) (citing RESTATEMENT (SECOND) OF CONTRACTS § 222 (1973), but apparently intending to reference Section 222 of the *First* Restatement, which dealt with oral rescission of a contract within the Statute of Frauds; the ALI did not even promulgate Restatement (Second) of Contracts Section 222 until 1979).

⁴ *See Cap. Funding v. Chase Manhattan Bank USA*, No. 04-4355, 2006 WL 1911019, at *4 (3d Cir. July 11, 2006) (applying Delaware contract law); *Crisalli v. ARX Holding Corp.*, No. 05-41016, 2006 WL 1049122, at *4 (5th Cir. Apr. 20, 2006) (applying Texas law); *Den Norske Bank AS v. First Nat’l Bank of Boston*, 75 F.3d 49, 58 (1st Cir. 1996) (applying Massachusetts law); *L.K. Comstock & Co. v. United Eng’rs & Constructors Inc.*, 880 F.2d 219, 223 n.2 (9th Cir. 1989) (applying Arizona law); *Sun Oil Co. of Penn. v. M/T Carisle*, 771 F.2d 805, 808 n.6 (3d Cir. 1985) (applying federal maritime law); *Stemkowski v. C. I. R.*, 690 F.2d 40, 45 n.5 (2d Cir. 1982) (applying federal tax law); *Austin v. Parker*, 672 F.2d 508, 517 (5th Cir. 1982) (applying Louisiana law); *Simon Wrecking Co. v. AIU Ins. Co.*, 530 F. Supp. 2d 706, 715-16 (E.D. Pa. 2008) (applying Pennsylvania law); *Great N. Ins. Co. v. ADT Sec. Servs., Inc.*, 517 F. Supp. 2d 723, 737 (W.D. Pa. 2007) (applying Pennsylvania law); *AstenJohnson v. Columbia Cas. Co.*, 483 F. Supp. 2d 425, 467 (E.D. Pa. 2007) (applying Pennsylvania law), *rev’d*, 562 F.3d 213 (3d Cir. 2009); *In re September 11th Liab. Ins. Coverage Cases*, No. 03 Civ. 0332, 2005 WL 425267, at *3 (S.D.N.Y. Feb. 23, 2005) (applying New York law); *Commercial Union Ins. Co. v.*

only five opinions from three states (including only one supreme court) have previously cited it for the proposition that an agreement need not be ambiguous for evidence of trade usage to be considered.⁵ Moreover, as XTO's request that this Court adopt Section 222 implicitly recognizes (XTO Br. 36), mere citation of a Restatement provision is not equivalent to adopting it as a part of Texas law. *See, e.g., Am. Tobacco Co. v. Grinnell*, 951 S.W.2d 420, 438 (Tex. 1997) (declining to adopt Restatement sections that had been cited in prior reported Texas cases).⁶ Since no court in Texas has adopted Section 222 or even based a holding on its tenets about using custom and trade evidence to interpret

Seven Provinces Ins. Co., Ltd., 9 F. Supp. 2d 49, 66 (D. Mass. 1998) (applying Massachusetts law); *Gov't of United Kingdom of Great Britain & N. Ireland v. Northstar Servs., Inc.*, 1 F. Supp. 2d 521, 525 (D. Md. 1998) (applying Maryland law); *Unicover World Trade Corp. v. Tri-State Mint, Inc.*, No. 91-CV-0255-B, 1994 WL 383244, at *8 (D. Wyo. Feb. 23, 1993) (applying Wyoming law); *Camden Iron & Metal, Inc. v. Bomar Res., Inc.*, 719 F. Supp. 297, 309 (D.N.J. 1989) (applying New Jersey law); *Harris Bank Naperville v. Morse Shoe, Inc.*, 716 F. Supp. 1109, 1121 (N.D. Ill. 1989) (applying Illinois law); *Binder v. Aetna Life Ins. Co.*, 75 Cal. App. 4th 832, 853 (Cal. Ct. App. 1999); *Employment Television Enters., LLC v. Barocas*, 100 P.3d 37, 42-43 (Colo. Ct. App. 2004); *New England Rock Servs., Inc. v. Empire Paving, Inc.*, 731 A.2d 784, 788 (Conn. App. Ct. 1999); *FleetBoston Fin. Corp. v. Advanta Corp.*, No. Civ. A. 16912, 2003 WL 240885, at *21 n.79 (Del. Ch. Jan. 22, 2003); *Intersport, Inc. v. Nat'l Collegiate Athletic Ass'n*, 885 N.E.2d 532, 539 (Ill. App. Ct. 2008); *Merchants Envtl. Indus., Inc. v. SLT Realty Ltd. P'ship*, 731 N.E.2d 394, 405 (Ill. App. Ct. 2000); *Affiliated FM Ins. Co. v. Const. Reinsurance Corp.*, 626 N.E.2d 878, 881 (Mass. 1994); *GTE Gov't Sys. Corp. v. Rackemann, Sawyer & Brewster, P.C.*, No. CA 901067C, 1996 WL 1185137, at *7 n.14 (Mass. Super. Ct. Apr. 4, 1996); *Gallegos v. Espinoza*, 39 P.3d 704, 706 (N.M. Ct. App. 2001); *Puget Sound Fin., L.L.C. v. Unisearch, Inc.*, 47 P.3d 940, 943 (Wash. 2002); *Geonerco, Inc. v. Grand Ridge Props. IV LLC*, 191 P.3d 76, 80 (Wash. Ct. App. 2008); *Mullinnix LLC v. HKB Royalty Trust*, 126 P.3d 909, 917 (Wyo. 2006).

⁵ *See Employment Television Enters., LLC*, 100 P.3d at 42-43; *Intersport, Inc.*, 885 N.E.2d at 539; *Merchants Envtl. Indus., Inc.*, 731 N.E.2d at 405; *Puget Sound Fin., L.L.C.*, 47 P.3d at 943; *Geonerco, Inc.*, 191 P.3d at 80.

⁶ Furthermore, the *Holmes* Court made only a “*cf.*” reference to a comment in the Restatement. 290 S.W.3d at 858; *see* THE BLUEBOOK: A UNIFORM SYSTEM OF CITATION R. 1.2, at 47 (Columbia Law Review Ass’n et al. eds., 18th ed. 2005) (explaining that “*cf.*” means that the “[c]ited authority supports a proposition different from the main proposition but sufficiently analogous to lend support. Literally, ‘*cf.*’ means ‘compare.’ . . .”).

unambiguous contracts, the citation in *Holmes* can best be described as “casual dicta.”

Perhaps the reason for such widespread judicial reluctance to embrace XTO’s approach is that Section 222, more than almost any other section of the Restatement, so markedly embodies the Corbinesque view that “words in themselves have no meaning.” 5 CORBIN ON CONTRACTS § 24.7 at 39 (1998). Until his death, Professor Corbin served as Consultant to the Second Restatement, and his posthumous influence permeated parts of the final product. See Robert Braucher, *Freedom of Contract and the Second Restatement*, 78 YALE L.J. 598, 598 (1969) (stating that Corbin’s review was “the basis for much of the work on the revision”); John E. Murray, Jr., *The Standardized Agreement Phenomena in the Restatement (Second) of Contracts*, 67 CORNELL L. REV. 735, 737 (1982) (“[N]ot only was Corbin a consultant to the new Restatement; those charged with its creation were, necessarily, heavily “Corbinized” before they assumed their new duties”).⁷ Corbin’s views on linguistic indeterminacy are more fulsomely set forth in his treatise, the current version of which asserts, in part:

⁷ Corbin’s influence on the project is evidenced by examining his letters to Professor Braucher during the process. See, e.g., Joseph M. Perillo, *Twelve Letters from Arthur L. Corbin to Robert Braucher*, 50 WASH. & LEE L. REV. 755, 769-71 (1993) (Corbin’s January 27, 1961 letter) (denouncing the plain meaning rule, on the ground that “no word or group of words . . . has an ‘objective’ meaning,” and asserting that “[w]hen a court excludes relevant evidence of the meaning given to the words of a contract by the parties thereto, on the ground that the words are not ‘ambiguous,’ it is making interpretation depend exclusively on its own linguistic education and experience”). In fact, the text of Section 222 parallels Corbin’s discussion of trade usage in the version of his treatise that was most current during the drafting process. Compare 3 ARTHUR CORBIN, CORBIN ON CONTRACTS § 555 at 128-130 (1951) (“It is not necessary that words should be unusual words or words that are ‘ambiguous on their face’ in order to admit evidence of special usage. Such evidence often establishes a special and unusual meaning definitely in conflict with the more common and ordinary usages.”), with RESTATEMENT (SECOND) OF CONTRACTS § 222 cmt. b (“There is no requirement that an agreement be ambiguous before evidence of a usage of trade can be shown, nor is it required that the usage of trade be consistent with the meaning the agreement would have apart from the usage.”).

One cannot assert too often or too vigorously that language at its best is *always* a defective and uncertain instrument It is therefore *invariably* necessary, before a court can give *any* meaning to the words of a contract and can select a single meaning rather than other possible ones as the basis for the determination of rights and other legal effects, that extrinsic evidence be admitted to make the court aware of the “surrounding circumstances,” including the persons, objects, and events to which the words can be applied and which caused the words to be used.

. . .

Sometimes it is said that the courts will not disregard the “plain language” of a contract. . . . A . . . better understanding of the uncertainties of language . . . will make one beware of holding such an opinion. A judge who believes that contract terms can have a single, reasonable meaning that is apparent without reference to extrinsic evidence of the parties’ intentions “retires into [a] lawyer’s Paradise”

5 CORBIN ON CONTRACTS § 24.7 at 30-33 (1998) (last quoting THAYER, PRELIMINARY TREATISE ON EVIDENCE 428) (emphases added). While Corbin’s treatise goes on to laud the Restatement (as well as the UCC and the U.N. Convention on Contracts for the International Sale of Goods), *id.* § 24.7 at 34-36, it expressly concedes that “the ‘plain meaning rule’ is adhered to by a majority of the jurisdictions in the United States.” *Id.* § 24.7 at 34.

Thus, while Corbin’s views may have prevailed within the academy,⁸ the

⁸ See e.g., Peter Linzer, *The Comfort of Certainty: Plain Meaning and the Parol Evidence Rule*, 71 *FORDHAM L. REV.* 799, 838 (2002) (after contrasting the plain meaning rule with “the Corbin way” for a dozen pages, positing that “we have a choice between greater certainty, with occasional injustices, and greater concern with what the parties actually intended, with occasional chicanery,” and concluding, as did Corbin, that “we should opt for the parties’ intentions, discerned from their words, read in the context of all relevant evidence, extrinsic or not”); Margaret N. Kniffen, *A New Trend in Contract Interpretation: The Search for Reality as*

vast majority of courts adhere to the notion that words have meaning and people can be bound by what they say. *See* E. ALLEN FARNSWORTH, *CONTRACTS* § 7.12 (4th ed. 2004) (“[T]he overwhelming majority of courts retain some kind of plain meaning rule.”); *accord* JOSEPH M. PERILLO, *CALAMARI AND PERILLO ON CONTRACTS* § 3.10 (5th ed. 2003); Eyal Zamir, *The Inverted Hierarchy of Contract Interpretations and Supplementation*, 97 COLUM. L. REV. 1710, 1716 (1997). In line with the majority approach, Texas courts have long adhered to the more traditional views of Professor Samuel Williston, who asserted that words have meaning and that the parties’ intent can be gleaned from the words they use in their contracts. *See* 11 WILLISTON ON CONTRACTS § 31.4 at 277-280 (4th ed. 2009) (“If the language used by the parties is plain, complete and unambiguous, the intention of the parties must be gathered from that language, and from that language alone, regardless of what the actual or secret intentions of the parties may have been.”) (footnotes omitted), *See e.g., Voluntary Hosps. of Am., Inc. v. Nat’l*

Opposed to Virtual Reality, 74 OR. L. REV. 643, 664 (1995) (“words used in a contract can never have a single plain meaning that is clear without any reference to the context”).

Of course, the Second Restatement’s approach is not universally revered in the Academy, attracting critics on both the left; *see, e.g.,* Ramona Paetzold, *Feminism and Business Law: The Essential Interconnection*, 31 AM. BUS. L.J. 699, 713 (1994) (“contract law highlights the law’s traditional separation of objective (the four corners of the document) and subjective (the intent of the parties) interpretation, all of which has worked to obfuscate the questions of power relations in contractual transactions. [One scholar]’s call for ‘noncommodification’ of the personal can perhaps provide new insights into . . . ‘private’ contracts in general.”); Clare Dalton, *An Essay in the Deconstruction of Contract Doctrine*, 94 YALE L.J. 997, 1000 (1985) (“our preoccupation with questions of power and knowledge is mirrored in doctrinal structures that depend on the dualities of public and private, objective and subjective, form and substance . . . which contribute to the inconsistency and substantial indeterminacy of contract doctrine”); *See, e.g.* Val D. Ricks, *The Possibility of Plain Meaning: Wittgenstein and the Contract Precedents*, 56 CLEV. ST. L. REV. 767, 804-05 (2008); Robert E. Scott, *The Case for Formalism in Relational Contract*, 94 NW. L. REV. 847, 859-60 (Spring 2000).

Union Fire Ins. Co. of Pittsburgh, 859 F. Supp. 260, 263 (N.D. Tex. 1993) (“With apologies to Derrida and de Man, the Court recognizes that an analysis of the [contract] language reveals that the definition of ‘insured’ as applied to the insured v. insured exclusion does not deconstruct itself into ambiguity. To read the language otherwise would be to adopt the textual methodology of the protodeconstructionist Humpty Dumpty, for whom words meant what he wanted them to.”), *aff’d*, 24 F.3d 239 (5th Cir. 1994) (per curiam).

Thus, far from being the “modern trend, as driven by RESTATEMENT (SECOND) OF CONTRACTS and the U.C.C.,” (XTO Br. 33), XTO’s invitation to construe the JOAs against the backdrop of a battle between expert witnesses is a distinctly minority view. XTO has provided no reason for this Court to take this case in order to change well-considered Texas law in this area.⁹

B. Even assuming the admissibility of XTO’s expert testimony, the court of appeals correctly held that it was legally insufficient to establish custom and usage.

As noted above, the court of appeals assumed without deciding that Barnhill’s testimony was admissible, but affirmed the summary judgment for Smith on the ground that XTO’s summary judgment proof failed to raise a genuine issue of

⁹ If the Court were to change the law in this regard, it should remand the case in the interest of justice so that Smith has an opportunity to raise its own controverting expert proof on the meaning of the JOAs, rather than render judgment based on witness Barnhill’s assertions, as XTO requests (XTO Br. 39). *See* TEX. R. APP. P. 60.2(f) (“The Supreme Court may vacate the lower court’s judgment and remand the case for further proceedings in light of changes in the law.”); *Westgate, Ltd. v. State*, 843 S.W.2d 448, 455 (Tex. 1992) (“The most compelling case for such a remand is where we overrule existing precedents on which the losing party relied at trial.”); *cf. Murray v. San Jacinto Agency, Inc.*, 800 S.W.2d 826, 830 (Tex. 1990) (“Since we have modified the law, we will remand this case in the interest of justice to the trial court.”).

material fact on custom and usage. 282 S.W.3d at 682. XTO has not shown any error in that holding, much less error of such importance to the jurisprudence as to warrant this Court's review.

Texas has long set a high bar for admitting custom and usage evidence to establish the meaning of a contractual term; conclusory or anecdotal testimony simply will not suffice. “The general rule in the case of contract is that the custom and usage must be so general that both [contracting parties] are presumed to be aware of them, or that they have actual knowledge of them, to be charged with having contracted with reference to such usage and custom.” *Barreda v. Milmo Nat'l Bank*, 252 S.W. 1038, 1039-40 (Tex. Comm'n App. 1923, judgment adopted) (citing 27 R.C.L. §§ 9 & 10). As one treatise explains:

When a usage or custom is relied on it must be established by clear and satisfactory proof. A usage or custom cannot be established by proof of specific instances or its recognition unless they are *sufficiently numerous to indicate a regular course of business*. . . . It is only where the evidence clearly establishes a fixed habit or custom that it possesses *any evidentiary* force. . . . Lack of definiteness and certainty is fatal to its existence.

37 TEX. JUR. 3d *Evidence* § 913 (3d ed.) (footnotes omitted) (emphases added).¹⁰

Although XTO claims that “Texas law is, to understate the matter, very confused with

¹⁰ This is the general rule in other American jurisdictions as well. See 21A AM. JUR. 2d *Customs and Usages* § 44 (2009) (“Evidence that . . . fails to establish the custom by proof of certain and uniform usage is insufficient to establish the validity or effectiveness of the custom. A custom or usage can only be proved by numerous instances of actual practices, and not by the opinion of a witness.”) (footnotes omitted); 25 C.J.S. *Customs and Usages* § 10 (2009) (“[A] party must be shown either to have had actual knowledge of a general usage of trade among carriers, or it must be shown to have been so general and notorious that the person is presumed to have known it”) (footnotes omitted).

respect to the proof necessary to show custom and usage in an industry,” (XTO Br. 32), the very cases it cites show the opposite—that this standard of proof has consistently remained the rule in Texas. *See Energen Res. MAQ, Inc. v. Total Minatome Corp.*, 23 S.W.3d 551, 556 (Tex. App.—Houston [1st Dist.] 2000, pet. denied); *Grube v. Donnell Exploration Co.*, 286 S.W.2d 179, 181 (Tex. Civ. App.—El Paso 1955, writ ref’d n.r.e.) (both cited in XTO Br. 32-33); *accord Fry v. Guillote*, 577 S.W.2d 346, 349 (Tex. Civ. App.—Houston [14th Dist.] 1979, writ ref’d n.r.e.).

As the court of appeals held, Barnhill’s affidavits fall woefully short of the minimum requirements of this Texas rule, offering only general and conclusory assertions. 282 S.W.3d at 682. Barnhill does not testify that the words “notice” and “elect” have any secret or specialized meaning in the oil and gas industry, as “usage of trade” evidence typically does. Nor does he even testify that these common terms are consistently and uniformly understood to have a particular meaning that gives particular rights and imposes particular duties in the oil patch. He merely recounts that three companies at unspecified times and places on some unspecified number of occasions have successfully changed their elections as non-operating working interest owners. But what is fatal to his client’s position is what he does not say. Among other things, Barnhill does not say whether:

- The operators sought or welcomed these changes;
- The operators believed that they had the legal right to reject such changes but elected, for whatever reason, not to do so;
- There were other non-operating working interest owners;

- The other working interest owners acceded to or resisted such changes;
- The other working interest owners had already changed their ownership positions in light of the initial election by the party who later sought the change;
- The other working interest owners had in any other way changed their circumstances in reliance on the initial election;
- There were other instances where such attempted changes have been disallowed by the operator; or
- Anything about these particular occasions actually did or should reasonably have placed Smith on notice that it should have acceded to Chevron's request and allowed the second election.

Barnhill's three anecdotes, devoid of any context, cannot constitute custom and usage evidence about the meaning of plain words like "elect" and "notice" in a widely-used form contract. Whatever the general admissibility of usage of trade testimony,¹¹ XTO's

¹¹ Recent empirical studies suggest that Texas's longstanding judicial skepticism about custom and usage proof is well taken. As one exhaustive commentary concluded:

[O]ne of the primary justifications for looking to custom to fill gaps and interpret contracts is that the customs themselves provide useful information to generalist judges about the intent of the parties, or failing that, about a range of practices whose widespread use suggests that they are viewed as reasonable by industry transactors. However, recognizing that the customs often evolve . . . where transactors trust one another and want to continue dealing, but that cases arise where the very trust that makes the custom workable has broken down, suggests that there is no reason to suppose that customs will provide useful information about what contracting parties would have agreed to had they included a provision stating how the matter . . . was to be dealt with if third-party adjudication were required. In addition, because so many customs have an implied precondition that the transactors trust one another, and because many customs condition on this and other information that is inexpensively observable, but may be quite expensive to verify (that is, to prove to a court with reasonable accuracy), even customs that are widely followed may be poor candidates for judicial enforcement. First, from an *ex ante* perspective, transactors are unlikely to want to spend an infinite amount of money establishing their case if a dispute arises. And second, third-party application of these types of customs may well be error prone. Transactors may therefore prefer a third party to apply a very different rule . . . less costly to dispute should a problem arise.

testimony is not probative evidence of custom and usage under well-established Texas law.¹²

Indeed, XTO makes no real attempt to prove that the court of appeals' holding was error under current law, but instead reurges its request that the Court adopt Section 222 of the Restatement, which it claims, without explanation, erects a lower threshold for proof of custom and usage. (XTO Br. 34-36.) But XTO provides no justification for departing from established Texas precedent. Moreover, it is far from clear that Section 222's standard for proving custom and usage is at all different from existing Texas law. *See* RESTATEMENT (SECOND) OF CONTRACTS § 222(1) ("A usage of trade is a usage having such regularity of observance in a place, vocation, or trade as to justify an expectation that it will be observed with respect to a particular agreement. . . ."); *id.* § 222 cmt. b ("Unless agreed to in fact, it must be reasonable, but commercial acceptance by regular observance makes out a prima facie case that a usage of trade is reasonable. . . ."). For all these reasons, the Court should reject XTO's invitation to review the court of appeals' holding on this issue.

Lisa Bernstein, *The Questionable Empirical Basis of Article 2's Incorporation Strategy: A Preliminary Study*, 66 U. CHI. L. REV. 710, 779-80 (1999). These problems are dramatically accentuated when, as here, the custom evidence involves only isolated occasions involving strangers to the current dispute.

¹² The Oklahoma authority that XTO cites as support for the *admissibility* of custom and usage does not speak to the *sufficiency* of Barnhill's testimony under Texas proof requirements for custom and usage. *See Oxley*, 936 P.2d at 944-46 (cited in XTO Br. at 29-30) (after determining that another provision of JOA was ambiguous, remanding for consideration of custom and usage evidence, without determining sufficiency of testimony submitted).

III. As a textual matter, XTO’s contrary interpretation is unreasonable as a matter of law.

Separate and apart from the issue of the Barnhill affidavits, XTO’s textual interpretation of Article VI.B is manifestly unreasonable. It inserts language into an unambiguous contract, is internally inconsistent, depends on imaginary straw people, and requires every case to turn on the specific circumstances of all involved parties, determinable only after a full trial on the merits. Because XTO’s proffered interpretation is not reasonable, the court of appeals correctly rejected XTO’s alternate claim that Article VI.B is ambiguous. 282 S.W.3d at 680-81.¹³

A. Well-established Texas law precludes XTO’s attempt to add words to the plain language of an unambiguous contract.

XTO has never gone so far as to claim that Article VI.B allows an owner to always, under any circumstances, change its mind at any time within the 30-day period. Instead, recognizing the bizarre and unfair circumstances that could result from a literal adherence to a 30-day “expiration date,” (XTO Br. 21),¹⁴ XTO merely claims that Article

¹³ See *Seagull Energy E & P, Inc. v. Eland Energy, Inc.*, 207 S.W.3d 342, 345 (Tex. 2006) (“[A] contract is not ambiguous merely because the parties disagree on its meaning. ‘An ambiguity exists only if the contract language is susceptible to two or more reasonable interpretations.’”) (quoting *Am. Mfrs. Mut. Ins. Co. v. Schaefer*, 124 S.W.3d 154, 157 (Tex. 2003)) (other citation omitted).

¹⁴ Allowing non-operating working interest owners to change their election at any time within the 30-day period would unreasonably disadvantage the operator in many situations. Time is often of the essence in the oil patch; an operator might need to drill before the end of the election period, *e.g.*, if other wells are draining a field, if prices have temporarily spiked, if favorable financing is immediately available, or if scarce equipment and qualified crews are already on site. See *Valence*, 164 S.W.3d at 662-63 (holding that this form JOA permits an operator to commence operations before the end of the 30-day period—or even before any other non-operating working interest owner has made an election—and recognizing the “potential benefits” to all owners of “an early start,” such as avoiding “the draining of an oil field by a neighboring operator or the expiration of an oil and gas lease”). But in such instances, “the risk

VI.B permits a party to change its election within those 30 days if “the other parties have not materially changed their positions.” (*Id.* at 18.) That position may be plausible as a practical matter, in that the parties *could* have made such an agreement, but it is wholly untenable as a legal matter, in that it is not tethered to the terms of the JOAs that the parties *actually* used.

XTO’s position adds words—a lot of them—to the JOAs. It is well established that Texas courts will “neither rewrite the parties’ contract nor add to its language.” *Am. Mfrs. Mut. Ins. Co. v. Schaefer*, 124 S.W.3d 154, 162 (Tex. 2003). The actual text of the JOA is an unavoidable casualty of XTO’s attempt to prevail without advancing a wholly impractical argument.¹⁵

In its *Nearburg* amicus brief, the AAPL specifically warned against the type of departure from contractual text that XTO advocates here. It urged the New Mexico Court of Appeals “to read and construe the clear language of the AAPL Model

of early commencement of such operations falls entirely on the operator because if none of the working interest owners consent to participation within thirty days, the operator bears the full costs of operations.” *Id.* at 663. If the working interest owners could opt in or out of a project as early indications of its success appear, they would all consent to successful ventures and all go non-consent to dry holes. Under such constraints, few prudent operators would bear the onus of undertaking costly operations if they had to share in the profits of a successful outcome yet bear all the costs of a failure.

¹⁵ As the court of appeals pointed out, XTO’s addition of the “materially changed” language also impermissibly robs Article VI.B’s 30-day deadline of any logical force. *See* 282 S.W.3d at 679 (“[I]f a party could change its election if the other parties had not materially changed their positions in reliance on the initial election, it is not clear why the ability to exercise such a privilege would be limited to thirty days after receipt of the proposing party’s notice.”); *see also Seagull Energy*, 207 S.W.3d at 345 (holding that courts should “‘examine and consider the entire writing in an effort to harmonize and give effect to all the provisions of the contract so that none will be rendered meaningless’”) (emphases omitted) (quoting *Coker v. Coker*, 650 S.W.2d 391, 393 (Tex. 1983)).

Form Operating Agreement as it is written and signed by the parties, *with no implications of additional terms*, to establish the rights and obligations of the parties to the contract.” (App. A at 15 (emphasis added).) The AAPL stated, “There is no reason why such a provision [permitting a change of election] must be contained in the contract or construed into the contract.” (*Id.* at 14.) On the contrary, it warned that “the ultimate result [of implying such a provision] will be less certainty and more litigation . . . over this commonly used contract form and more business risk to the parties to such transactions, which unnecessarily adds to the cost of oil and gas exploration and operations.” (*Id.* at 11.)

As the court of appeals observes, another form operating agreement that is less commonly used in the industry *does* expressly permit working interest owners to change their election.¹⁶ The parties could have used that form, or rewritten this particular section of the JOAs to permit a re-election. Since they did neither, the courts below properly refused XTO’s invitation to make a new contract for them.

B. XTO’s interpretation is internally inconsistent.

XTO’s interpretation is also unreasonable because it contains a fatal internal inconsistency. On one hand, XTO maintains that it was common knowledge throughout the industry and perforce to all parties that owners can change their position on going consent or non-consent up until the last day of the 30-day period. (XTO Br. 9-

¹⁶ See 282 S.W.3d at 680 (citing ROCKY MOUNTAIN OIL & GAS ASS’N FORM 3, ART. 9, § 9.2 (1959) & FORM 2, art. 8, § 8.6 (1955), *reprinted in* 7 HOWARD R. WILLIAMS & CHARLES J. MEYERS, OIL AND GAS LAW §§ 920.4, 920.5 (1995)); *see also* *Nearburg*, 943 P.2d at 570 (citing same).

10.)¹⁷ On the other hand, XTO concedes that, if an owner materially changes its position in reliance on another owner’s initial election, then that initial election becomes binding. (*Id.* at 18, 28.) This concession betrays XTO’s true lack of confidence in its position. If everyone in the industry knows that elections are provisional until the last moment, then how could—or why would—anyone detrimentally rely on such a “sometime thing”?

The answer, of course, is that electing to go consent or non-consent is not some passing fancy, but serious business. Consistent with the JOAs, Smith’s notices asked for cash within 15 or 30-days of receipt, and the AFEs that it required consenting owners to sign and return specified the amount owed for participation. (3 CR 660-75.) All parties thus had to consider their options carefully, deciding whether the known risk was worth the potential gain. This decision would not normally be made in a vacuum, but in light of all surrounding circumstances—competing opportunities, financing availability, and, in some instances at least, the choices made by other owners.¹⁸ Yet under XTO’s approach, such planning would always be tentative, since one’s share of the total investment could always change—up or down—because elections are merely tentative for a 30-day period. From both a practical and textual standpoint, XTO’s interpretation makes no sense.

¹⁷ Of course, XTO’s “expert” proof falls far short of living up to this claim, as shown above. (*See* Part II.B *infra.*)

¹⁸ (*See* 3 CR 571, 604 (art. VI.B.2, entitled “Operations by Less than All Parties”).)

C. XTO's interpretation is grounded in false premises.

XTO tries to buttress its interpretation by suggesting that the court of appeals' construction results in "multiple termination dates of the 30-day notice period," (XTO Br. 15), which "defies belief" since it would lead to different deadlines for the commencement of operations. (*Id.* at 22.) But XTO's own interpretation can lead to multiple termination dates as well: under XTO's theory, if the non-operating working interest owners receive the operator's notice on different dates, the 30-day period expires as to each on different dates.¹⁹ Thus, the mere fact that the court of appeals' interpretation can result in multiple termination dates does not provide any reason to disregard it in favor of XTO's interpretation.

Moreover, XTO imposes a false constraint. The court of appeals need not be right in all particulars to have reached the right result in this case. The court's observation that the Notice Period is deemed ended once every party has made its election may or may not be correct, but it is, without doubt, dicta. 282 S.W.3d at 678. The only question in this case is whether a party may change its election after giving notice to the drilling operator. The court below reached the right result—there is only one election. As a practical matter, that means that "[o]nce a receiving party timely gives notice of its election regarding the drilling operation by properly replying within the thirty days, the Notice Period has expired as to that Party." *Id.* Whether it follows as a legal matter that, for purposes of later deadlines, the Notice Period ends once all non-

¹⁹ (See XTO Br. 21 ("It is clear from a reading of Article VI.B, as a whole and harmonizing all of it [sic] provisions, that there is a 'fixed' 30-day notice period that begins to run when the receiving party receives notice of the proposed operation."))

consenting parties send notice of their election is, Smith submits, an open question that need not be decided here. The second proposition does not ineluctably follow from the first, and any logical or legal defects in the latter should not be attributed to the former. XTO's efforts to conflate the two is merely a reverse bait-and-switch tactic.

D. XTO's interpretation would ordinarily create a disputed issue of material fact whenever an owner attempts to change its election.

Because XTO's claim is based not on the text of the provision, but on the bits and pieces discussed above and two conclusory affidavits, XTO only moved for a partial summary judgment and never asserts in this Court that its position entitles it to a judgment as a matter of law. Rather, XTO's rather convoluted prayer is as follows:

[T]he Court should . . . hold that Article VI.B.1 permits a party to change its election to participate in a subsequent operation – *if* that election is changed within the 30-day notice period for that operation and *if* the other parties to the JOA have not materially changed their positions in reliance on the party's initial election. Whereupon, the Court should remand the case to the trial court [1] for a determination of whether, or not, the parties to the JOAs materially changed their positions in reliance upon Chevron's initial elections, and [2] for trial of the other issues related to XTO's contract cause of action. *Alternatively*, the Court should find that Article VI.B. of the JOAs is ambiguous, reverse the judgments of the courts below and remand the case for a trial on the merits.

(XTO Br. 39-40 (emphases added).)

Requiring a jury to decide reliance in every case, or alternatively to interpret the terms of the decades-old form JOA afresh in every case, would inevitably cause expense, delay, and uncertainty, as well as expose operators to the potential for double liability. Even if XTO's position had some basis in the JOAs' language, it would

still be unreasonable as a matter of law because the parties could not have intended to lateral the construction of this simple provision to such a complicated, cumbersome, and ultimately unfair process.

1. XTO's litigation-based approach undercuts the very purpose and advantage of an industry-wide form JOA.

This is not a situation where the parties negotiated and drafted their own contract, forming at least a personal, subjective intent of the meaning of each provision, and perhaps a mutual intent as well. In those circumstances, a factfinder is peculiarly able to discern the most just result. Nor is this a situation where one party drafted the contract with little or no opportunity for the other side to negotiate or even object to the terms. There, it makes sense for a court to use familiar rules like resolving ambiguity against the drafter or invoking public policy considerations to decide the case.

Here, entirely different policy considerations obtain. The AAPL led a comprehensive, arduous effort to develop the original 1956 Form 610 Model JOA. *See* John R. Reeves & J. Matthew Thompson, *The Development of the Model Form Operating Agreement: An Interpretative Accounting*, 54 OKLA. L. REV. 211, 214 (2001). Since then, the AAPL has promulgated several revised versions of the JOA, including the 1982 version used here. *Id.* at 214-15. Unlike some form agreements available in other industries, the JOA does not reflect the perspective of any particular “side,” since landmen and their employers may be operators on some leases and non-operating working interest owners on others.

The great advantage of the AAPL's form JOA is that parties can employ it

without negotiating, discussing, or even reading most of its provisions. All sides trust the JOA because it has been used for more than 50 years on leases large and small throughout the nation. (See App. A at 10 (explaining that “Landmen . . . usually use the preprinted Model Form Operating Agreement published by AAPL” and that “thousands of oil and gas transactions are entered into annually using the AAPL Model Form Operating Agreement”).) Parties can save the time, expense, and exposure of individual negotiations about a complex relationship because they regard the JOA as fair, balanced, and clear. (*Id.* at 16.) The parties here left Article VI’s relevant terms unchanged, and there was no evidence these terms were discussed or even considered during negotiations.

Parties who sign a JOA should not have to fear that that they are “buying a lawsuit,” at least not regarding the standardized, non-technical provisions at issue here. Courts should construe the JOAs as a matter of law, adding to the body of law that enhances the certainty and usefulness of the form agreement for everyone. See, e.g., *Polk v. St. Angelo*, No. 03-01-00356-CV, 2002 WL 1070550, at *2 (Tex. App—Austin May 31, 2002, pet. denied) (not designated for publication) (describing industry association’s form contract as “designed to facilitate uniform transactions and application”); *Halperin v. Nichols, Safina, Lerner & Co.*, No. 94 C 6960, 1996 WL 634037, at *5 (N.D. Ill. Oct. 29, 1996) (“In interpreting a contract, particularly a form contract, the appropriate standard is an objective, uniform interpretation.”). The benefits of avoiding point-by-point negotiation over each term disappear if the parties risk a lawsuit anytime a disagreement arises.

A particularly apt explanation of these principles was set forth in *Canel v.*

Federal Home Loan Mortgage Co.:

A standardized agreement is to be interpreted whenever reasonable as treating alike all those similarly situated, without regard to their knowledge or understanding of the standard terms of the writing. RESTATEMENT (SECOND) OF CONTRACTS § 211(2) (1982). This rule plainly subordinates the meaning that an individual party may have attached to the contract language to the goal of equality of treatment for parties who are similarly situated. FARNSWORTH ON CONTRACTS § 7.12 (1982).

No. 85 C 1424, 1985 WL 2929, at *3 (N.D. Ill. Sept. 30, 1985). Similarly, in contrasting boilerplate in an indenture with “contractual provisions which are peculiar to a particular indenture,” the Second Circuit explained:

The use of standardized language can result in a better and quicker understanding of those provisions and a substantial saving of time not only for the draftsman but also for the parties and all others who must comply with or refer to the indenture Boilerplate provisions are thus not the consequence of the relationship of particular borrowers and lenders and do not depend upon particularized intentions of the parties to an indenture. There are no adjudicative facts . . . for a jury to find and the meaning of boilerplate provisions is, therefore, a matter of law rather than fact.

Sharon Steel Corp. v. Chase Manhattan Bank, 691 F.2d 1039, 1048 (2d Cir. 1982) (quoting ABA FOUND., COMMENTARIES ON INDENTURES (1971)); see *Leverso v. SouthTrust Bank of Ala., N.A.*, 18 F.3d 1527, 1534 (11th Cir. 1994).

One commentator, in explaining “why standard form contracts require a treatment different from traditional contracts,” posited six underlying assumptions, including this: “To adjudicate standard form contracts in an appropriate manner, the law’s answer must be standardized.” Eric Mills Holmes, *A New and Old Theory for*

Adjudicating Standardized Contracts, 17 GA. J. INT'L & COMP. L. 323, 340 (1987). The author noted that it simply “exceeds the capability of the courts to subject every contract incorporating standard form terms to an individual inquiry into the particular circumstances of the formation and operation of the contract[']s terms. . . . It is . . . easier to find one court that can make a good decision guiding the formulation of a million standardized contracts than to find a million judges who can appropriately adjudicate as many contracts by giving consideration to the particular circumstances of . . . each contract.” *Id.*²⁰

2. XTO’s “let a jury sort it out” approach places an operator faced with a change in election in an untenable position.

XTO’s litigation-based approach has another, equally damning flaw: it inevitably risks inconsistent results and the imposition of double liability on an operator. Here, for example, XTO has sued only Smith. If XTO were to prevail, it would recover all the profits of full participation from Smith—even though Smith has already paid a substantial portion of those profits to the three owners who agreed to carry their proportionate share of Chevron’s costs before Chevron tried to change its election.

²⁰ Most commentators simply assume that one party to a standard form contract has a dominant bargaining position over the other. *See, e.g.*, Murray, *The Standardized Agreement Phenomena*, 67 CORNELL L. REV. at 762-82; W. David Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 HARV. L. REV. 529 (1971). *But cf.* Susan Randall, *Freedom of Contract in Insurance*, 14 CONN. INS. L.J. 107, 146-47 (2007) (“The extensive regulation of insurance policy language, ranging from legislatively-mandated provisions to required administrative approval of policies, renders the model of private contract . . . irrelevant in interpretation of insurance policies. Courts should approach the construction of insurance policies mindful that they are not individually negotiated bargains but highly regulated documents; the judicial goal should be ascertaining and effectuating regulatory goals, rather than the illusory intent of the parties.”).

To defend itself, Smith has three unpalatable choices: bring third-party actions against the consenting parties in XTO's primary suit, sue the consenting parties in a subsequent case if XTO secures a judgment, or pay XTO's newly-determined profit share twice. The first choice would directly inject the other owners, with whom Smith has an ongoing relationship, into a dispute to which they are only tangentially related. The second choice would oblige Smith to litigate XTO's case all over again, with the attendant risk of inconsistent results. *See Eagle Props., Ltd. v. Scharbauer*, 807 S.W.2d 714, 721 (Tex. 1990) (recognizing rule that "collateral estoppel cannot be asserted against a party who was not a party or in privity with a party in the prior litigation") (emphasis omitted). The third choice would cost Smith a substantial portion of the profits it earned from its operations.

In fact, XTO's "leave it to the jury" interpretation leaves no "safe" option for an operator confronted with an attempted second election. Had Smith allowed Chevron to change its election—and correspondingly reduced the interests of the other owners who had already elected to assume Chevron's share—those other owners could presumably have sued for profits they lost after Smith "improperly" allowed the second election. But if the new wells had not produced in paying quantities, the other consenting parties could presumably have sued for the additional costs they incurred when Smith "improperly" refused to allow Chevron's second election. Since, under XTO's "fairness" approach, only the factfinder can decide whether parties "have materially changed their positions based upon the initial election," an operator can never be sure which course might subject it to liability. An interpretation of a form contract that does not permit

even careful operators to structure their conduct to avoid liability cannot be correct. *See Frost Nat'l Bank v. L & F Distribs., Ltd.*, 165 S.W.3d 310, 312 (Tex. 2005) (per curiam) (“We construe contracts ‘from a utilitarian standpoint bearing in mind the particular business activity sought to be served’ and ‘will avoid when possible and proper a construction which is unreasonable, inequitable, and oppressive.’”) (quoting *Reilly v. Rangers Mgmt., Inc.*, 727 S.W.2d 527, 530 (Tex. 1987)).

PRAYER

Smith respectfully requests the Court to deny XTO’s petition. Because this case involves an issue of first impression, the Court might be tempted to address it, even though the court of appeals’ decision is the only reported pronouncement on the interpretation of this particular provision of a form that has been widely used for more than half a century. If the Court does conclude that it should settle this issue under Texas law, Smith submits that the Court should either refuse the petition for review or affirm the court of appeals’ judgment by a summary *per curiam* opinion. Smith requests such further relief to which it may be deemed justly entitled.

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CERTIFICATE OF SERVICE

I certify that a true and correct copy of the foregoing response to brief on the merits was served by certified mail, return receipt requested, on the following counsel of record on December 14, 2009:

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