“A Deal Is a Deal,” Says the Fifth Circuit

Michael A. Sabino

Not long ago, while suffering through Contracts in my first year of law school, I questioned my attorney-father about what it takes to create a final, enforceable contract in a business setting. Dear old dad then regaled me with the epic story of the Pennzoil-TexasCo litigation from his younger days, when the former obtained a $10 billion judgment against the latter after a Texas jury found TexasCo guilty of stealing away Getty Oil from Pennzoil after Pennzoil had taken substantial and definitive steps to put into writing an agreement to merge. In so many words, the drama of Pennzoil v. TexasCo exemplified that “a deal is a deal,” especially when it has been fully or substantially executed in a written, signed agreement.

The appellate court’s decision will reverberate in the oil and gas industry for years to come.

The complexity and seriousness of transactions in the energy sector, be it for drilling rights, royalties, and the like, are never left to oral contracts or a firm handshake. There is no deal until it is in writing and signed by all concerned parties. Until the ink is dry, anyone can walk away.

Equally so, once the contract is reduced to writing and signed, the relationship of the parties is now controlled by the terms of the accord and is enforceable in a court of law. The omission of certain details or subsequent steps dependent upon meeting certain conditions does not negate the contract; it remains to the parties to either act in good faith to close those gaps or, failing mutual agreement, let a court make a judgment as to who is right or wrong, as was the exact case in Coe.

That said, let us turn to this new holding. Equally so, once the contract is reduced to writing and signed, the relationship of the parties is now controlled by the terms of the accord and is enforceable in a court of law.

Coe and others were principals of Peak Energy Corporation, which held sizeable oil and gas leaseholds in the Haynesville Shale Formation, a vast reservoir of natural gas situated across eastern Texas and extending into neighboring southwestern

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Arkansas and northwestern Louisiana. Chesapeake Exploration, L.L.C., is a subsidiary of Chesapeake Energy Corporation. It badly wanted to purchase “deep rights” (i.e., the exclusive right to drill for natural gas at certain, very deep depths into the Haynesville Shale on land to which Peak already held the mineral rights).

Indeed, Chesapeake wanted those rights so badly, it was willing not only to pay, but to overpay for them. In addition, it not only wanted some leasehold rights, but had a voracious appetite to lock up as much leasehold acreage as Peak would agree to sublease. Representatives from Chesapeake ardently pursued Peak, and a verbal agreement was soon struck.

VALUE OF ASSETS DECLINES BEFORE CLOSING

The timing of all this plays a crucial role. When the deal was first sought in 2008, natural gas prices “were soaring,” in the words of the Fifth Circuit. Even so, Chesapeake agreed to pay an astounding $15,000 an acre for drilling rights to Peak’s holdings, a “hefty sum” even in that overheated market, according to the federal court.

The verbal accord was first reduced to a July 2008 letter encaptioned “Offer to Purchase,” which unequivocally put on the table an offer of slightly over $81 million in cash to be paid by Chesapeake to Peak for all of the latter’s right, title, and interest in specified oil and gas leases. The offer sheet contained a specific deadline for acceptance and insisted on a closing date of August 31 of that same year. Representatives of each side signed the letter.

But what accompanied the letter was key. Attached to the Offer to Purchase was a map (on letter-sized paper) of Harrison County, Texas, and adjacent vicinages. A number of sections of the map were clearly marked off with the word “PEAK” next to them, obviously delineating the territory to be sold.

Three weeks after executing this accord, Chesapeake asked Peak to prepare a final, written list of the leaseholds to be conveyed. This task, and the finalization of other closing documents, was time-consuming, so the two sides mutually agreed to extend the closing date. Up to this point, Chesapeake was unflinching in its commitment to close the deal.

In early October 2008, a sharp decline in natural gas prices degenerated into a free fall. Now the land Chesapeake had so willingly agreed to pay $15,000 an acre for was worth barely $3,000 for the same plot. Chesapeake started to get cold feet, and first requested to postpone the closing again until a date in January 2009. Less than a week later, Chesapeake declared it would not close at all.

The next stop was the courtroom, as Peak understandably wanted the contract enforced.

OFF TO FEDERAL COURT

Chesapeake interposed some rather prosaic defenses. First, it asserted the July letter agreement was a classic “agreement to agree,” and thus did not constitute an enforceable contract. Next, the defendant tossed out an equally time-honored “statute of frauds” defense, essentially the centuries-old contract law precept that an agreement is only enforceable in a court of law if reduced to a writing containing all the essential terms of the deal. Lastly, Chesapeake countered that the letter “was too indefinite to be enforced.”

The federal district court held a “bench” trial—that is, without jury. And while proceeding without a jury, the trial judge did call in an oil and gas attorney to act as an expert, for the sole purpose of reviewing the various maps and documents that purportedly demarcated the exact leaseholds to be conveyed. Clearly, the judge viewed as essential to the enforceability of this alleged contract the ability to identify what land rights were to be conveyed.

After deliberations, the district judge ruled that Peak had a valid, enforceable contract with Chesapeake and ordered the latter to pay over $19 million in damages for reneging on the contract. The damages number was reached by multiplying the number of acres found subject to the accord, well over 1,600, by $12,000 (the aforementioned contract price of $15,000 minus the $3,000 fair market value of the acreage when the alleged breach of contract occurred).

Chesapeake appealed to the Fifth Circuit.

FIFTH CIRCUIT ENFORCES THE AGREEMENT AS A TRUE COMMITMENT

Writing for the tribunal, the renowned Circuit Judge Patrick E. Higginbotham (once on the “short list” for the US Supreme Court) first tackled Chesapeake’s allegation that the Offer to Purchase was defective under the statute of frauds. Chesapeake’s contention was that the offering letter “does not adequately identify the property to be conveyed.” Texas law,
Judge Higginbotham duly noted, insists that any contract conveying land or rights therein “must furnish within itself, or by reference to some other existing writing, the means or data by which the property to be conveyed may be identified with reasonable certainty.”

**Key Map Locates Intent**

Paving the way for its ultimate decision, the Fifth Circuit noted that a map referenced in an agreement to convey property “may be used as an aid . . . as long as it contains enough descriptive information which, when considered . . . make[s] location of the land possible.” If that map “contains a sufficient nucleus of description,” then a court may entertain parol evidence (i.e., verbal testimony) to further illuminate the exact contours of the land to be conveyed (emphasis supplied). This is to be distinguished, noted the tribunal, from relying exclusively upon oral testimony to ascertain the property to be conveyed, which is clearly impermissible under centuries of statute of frauds jurisprudence. Citing the Texas landmark of *Wilson v. Fisher,* the Fifth Circuit in *Cheetah Gas Co. v. Chesapeake Louisiana* was dispositive, as it too dealt with a lack of a comprehensive description of the land to be conveyed, and thus failed to meet the statute of frauds.

But the defendant’s arguments were rejected. To be sure, said the tribunal, the exact language used in the Offer to Purchase had never been tested in a Texas state court. Yet that was of no moment, as the Fifth Circuit ruled with ease that the relevant document was enforceable under the state’s codification of the statute of frauds.

“A central purpose of the statute of frauds’ ‘reasonable certainty’ requirement,” opined Judge Higginbotham, is to prevent an unintended conveyance of real property, caused by an “unclear contract.” Yet the certitude the law demands is not restricted to a description based upon the traditional metes and bounds; other means of identification “may suffice to achieve ‘reasonable certainty.’”

Turning to the case at bar, the tribunal noted that the offering letter here contained a number of critical terms and conditions for the Haynesville acquisition, including the express conveyance of well over 5,000 acres, a net revenue interest of 75 percent, and drilling rights to cover all depths and shale formations. And, of course, there was the attached map. The Fifth Circuit reiterated the description of the map as covering specific counties and clearly evidencing what belonged to the plaintiff Peak, implicitly (if not explicitly) to consummate the sale.

How and by whom the map was generated was also germane to the court’s analysis. The Fifth Circuit noted the map had been created by Chesapeake, using advanced software. It was quite detailed, delineating county and city boundaries and waterways and providing an accurate depiction of landowners, all tied down by precise GPS coordinates. Lastly, the map referenced land surveys and real property abstract numbers, a hallmark to determining legal title in any conveyance of real property or the right to drill upon it.

Against all this, Chesapeake nonetheless countered that the letter agreement still lacked that “sufficient nucleus of description” so vital under local law to satisfy the Texas statute of frauds. Insisting that the offer sheet merely made generic characterizations of unspecified oil and gas leaseholds, the defendant cited precedents that deemed such generalizations insufficient to convey land. In particular, Chesapeake contended that the case of *Cheetah Gas Co. v. Chesapeake Louisiana* was dispositive, as it too dealt with a lack of a comprehensive description of the land to be conveyed, and thus failed to meet the statute of frauds.

The defendant’s arguments were rejected.
Next, the court disposed of the defendant’s contention that the parties lacked the intent to be bound by the document. The Fifth Circuit highlighted Chesapeake’s request to conduct due diligence, and the related execution of a confidentiality agreement. Indeed, and contrary to Chesapeake’s allegation that the confidentiality agreement was evidence that no deal was yet in place, the appeals court found quite the opposite; the confidentiality agreement was put into place sometime after the Offer to Purchase was executed. It was but a generic stipulation that did nothing to diminish the firm accord already reached, but, more important, did not detract from the material terms already reached in the offer sheet, nor from the parties’ intent to be bound by its terms.

**Documents and Actions Show Intent to Make the Agreement Binding**

Thus rebuffed, Chesapeake resorted to its next argument, that the Offer to Purchase was still too indefinite to be enforced. This question was strictly legal and was tackled by the appellate court, based upon the maxim that an agreement must be descriptive enough to enable a court to understand each party’s obligations before it can enforce them. Conversely, an accord that leaves material issues in doubt is not enforceable, as it constitutes a mere agreement to agree.

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Yet it is true, opined Judge Higginbotham, that parties that choose to leave nonessential terms open for subsequent negotiation can do so without endangering the validity of the basic agreement. That legal axiom thus implicates the related issue of what is an essential term versus what is not material, which would lead to the ultimate determination of whether the agreement before the court was enforceable.

Having set forth the controlling law, the Fifth Circuit was ready to make its determinations. First, the court found the Offer to Purchase was plain on its face that the accord was valid and binding, fully intended to convey land, and was fully executed. Finally, Chesapeake’s repeated insistence that it had no intention of backing out of the deal was further evidence of the parties’ relationships and their course of dealings.

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**And It Was Definite Enough . . .**

Rapidly running out of arguments, Chesapeake reasserted its contention that the Offer to Purchase was nonetheless too indefinite to form a valid contract. The Fifth Circuit disagreed. Writing for the court, Judge Higginbotham ticked off a sampling of “essential terms” that any contract requires to be enforceable: a recitation of the goods or services to be rendered, the price, and the time of performance. The executed offer sheet contained all those key elements, ruled the tribunal, “as it identified the property to be conveyed, its price, the closing and delivery dates, and [Chesapeake’s] interest in the property.”

Yet the defendant persisted in its argument, now asserting that the offering document executed by the parties lacked closing documents, a final lease schedule, revenue interests, and other details. Such purported shortcomings made the document no more than an “agreement to agree,” the defendant argued.

The tribunal found these contentions to be without merit. First, an absence of closing documents does not necessarily make a contract nonbinding, declared the court. The tribunal had already found the relevant document contained all the essential terms of the parties’ accord. That rendered the Offer to Purchase valid without needing more. Indeed, the lack of closing documents and a final lease list did not hamper the enforceability of that document.

Finally, the Fifth Circuit disposed of Chesapeake’s insistence that the signed offer sheet lacked an accord on such alleged imperatives as depth limitations, noncompetitive
provisions, and the like. First, depth provisions were in the Offer to Purchase, reminded the appellate court. Moreover, Chesapeake provided no legal authority, found the tribunal, for the assertion that such matters were essential terms to a contract to convey an interest in oil and gas, as opposed to “terms that the parties could leave open for later negotiation.”

Thus having disabused all of Chesapeake’s arguments, the Fifth Circuit firmly declared that the Offer to Purchase was “sufficiently definite to be enforced.” All that remained was a review of the lower court’s calculation of damages. Here the Fifth Circuit made short shrift of the matter, noting first Peak had carried its burden as the plaintiff to prove its figures, and the calculus of taking the difference between the contract price and the market value of the acreage, and then multiplying the number of acres that were to be sold produced a logical and legally valid number.

And so ended Coe v. Chesapeake Exploration, in favor of enforcing the contract to Peak’s benefit.

A DEAL IS A DEAL

Much of the Fifth Circuit’s ruling in Coe is self-evident, and so we avoid mere embellishment in favor of some pithy observations. The first is purely one of business acumen; much of the reason the defendant was ensnared in this predicament was that it plunged headlong into this leasehold deal. With respect, Chesapeake was simply too anxious, and thus vastly overpaid, probably sought too many acres, and was simply unprepared for a market decline that would render its acquisition unwise. And so the first observation is there is much to be said for patience and caution, probably more so in the sometimes volatile field of energy exploration and production.

Now, to the more prosaic issues of law. Conventional wisdom rightly posits that the more detail in a contract, the better. Comprehensive contract language eliminates much uncertainty and can even forestall litigation when a business venture goes awry. Yet a crucial lesson of Coe is that too much detail too soon in a contemplated transaction can prove to bind the parties to an agreement they are not yet ready to make on terms they are not yet ready to agree to.

This is the fundamental point of Coe. In its haste to get the deal done, Chesapeake rushed headlong into making Peak not just an offer, but submitting to it a detailed, essentially final contract document. And once Peak signed, well, as our title proclaims, “a deal is a deal.” That is unequivocally what the Fifth Circuit upheld as the law.

In contradistinction, if the defendant had been more circumspect, and made a far more generalized offer to Peak, truly a mere “agreement to agree,” no doubt the result would have been far different. It is not that any sensible business endeavors to be vague in its dealings, but in this instance if the defendant has restricted itself to mere generalities, then it is a near certainty that the Fifth Circuit would have sided with this defendant and found that no enforceable contract existed.

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To be sure, offer sheets, memoranda of understanding, and contracts can only be analyzed on a case-by-case basis. But the panel’s exposition of the underlying facts in Coe, particularly as to the nuances of the oil and gas industry, set forth a number of benchmarks that industry players can study and use in crafting their own preliminary offers and final contracts.

In closing, we commenced here with the history lesson of Pennzoil v. Texaco that a deal is a deal. The Fifth Circuit in Coe has reaffirmed that basic notion and provided some ground rules for the energy industry and other businesses to follow.

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NOTES

1. ___ F.3d ___ (5th Cir. 2012).
2. 188 S.W.2d 150, 152 (1945).
4. See also Texas Builders v. Keller, 928 S.W.2d 479, 481 (Tex. 1996).
5. Almost as an aside, the tribunal likewise rejected Chesapeake’s last gasp; to wit, Peak was in breach because it was unable to deliver all the acreage originally contracted for. The panel dismissed that allegation on the defendant’s own choice in the offer sheet of the phrase “more of less” prefacing the stipulated amount of acres to be sold, noting that some discrepancy between the number of acres originally contracted for and the number to be subsequently delivered was an adjustable term that did not render the contract unenforceable.