No. 10-0648

In The Supreme Court of Texas

EL PASO FIELD SERVICES, L.P. AND GULFTERRA SOUTH TEXAS, L.P. F/K/A EL PASO SOUTH TEXAS, L.P.,
Petitioners,

v.

MASTEC NORTH AMERICA, INC. AND MASTEC, INC.,
Respondents.

On Petition for Review from the First Court of Appeals, Houston, Texas, Court of Appeals No. 01-07-00319-CV

PETITION FOR REVIEW

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STATEMENT OF THE CASE

Nature of the case	This contract case is about risk allocation. The contract puts "**all risks**" of certain underground problems on the contractor, "**notwithstanding**" anything that the owner may have said anywhere else. But the contractor (on whom "**all risks**" were put) wants $4.75 million more than the contract price.
Trial court	Hon. Sharon McCally, 334th Jud. Dist. Ct. of Harris County
Disposition at trial	The jury found a breach of the contract. *See* **Tab 1**. The jury awarded the plaintiff $4.75 million in damages. Judge McCally granted a JNOV. She held that the "all risks" provisions of the contract are enforceable. *See* **Tab 2.**
Parties on appeal	Plaintiff-Appellant MasTec North America, Inc. Defendant-Appellee El Paso Field Services, LP
Court of appeals	Houston [1st Dist.]
Disposition on appeal	JNOV reversed (2-1) and $4.75 million verdict reinstated. The Majority held that "all risks" does not mean "all risks." (per Higley, J., joined by Keyes, J.). On rehearing, the Majority wrote a new opinion. *See* **Tab 3**. It held that it is bound by a 1914 (pre-*Erie*) pronouncement of general federal common law. *Id.* at 49; *but see Erie R.R. v. Tompkins*, 304 U.S. 64 (1938). Justice Jennings dissented. *See* **Tab 4**. Defendant moved for en banc rehearing on conflict grounds. *See Enterprise Leasing Co. v. Barrios*, 156 S.W.3d 547, 549 (Tex. 2004) (*per curiam*) ("'all losses' means all losses"). Defendant obtained two more votes (Radack, C.J., and Alcala, J.) but not a majority. *See* **Tab 5**.

STATEMENT OF JURISDICTION

Jurisdiction is proper under Tex. Gov't Code §§ 22.001(a)(1), (a)(2), and (a)(6).

1. Dissent. The dissent by Justice Jennings creates dissent jurisdiction.

2. Conflict. There is conflict jurisdiction because the decision conflicts with the holding in *Enterprise Leasing* that "all" means all. The decision also conflicts with *Lonergan v. San Antonio Loan & Trust Co.*, 101 Tex. 63, 104 S.W. 1061 (1907), which states the Texas rule about how to allocate risk in construction contracts.

3. Importance. These errors are important because they create uncertainty about risk allocation in construction contracts.

4. Importance. It is also important to correct the refusal to follow *Lonergan*. The court of appeals rejected *Lonergan* because it thought itself "bound" by some pre-*Erie* general federal common law regarding contract interpretation. *See* **Tab 3** at *22 ("we are bound by the holding of the United States Supreme Court in *Hollerbach v. United States*, 233 U.S. 165, 34 S. Ct. 553 (1914), which was decided on similar facts and is cited by [the plaintiff] MasTec."). Contrary to that view, this contract case is controlled by **Texas** contract law, not by the old general federal common law. The old risk-shifting rule of federal law (a) was never adopted in Texas, (b) is contrary to *Lonergan*, (c) was rejected in *City of Dallas v. Shortall*, 131 Tex. 368, 114 S.W.2d 536 (1938), and (d) does not weaken the holding in *Enterprise Leasing* that "all" means all.

ISSUES PRESENTED

1. The contract states that "all risks" of certain underground problems fall on MasTec. It adds that MasTec "assumes full and complete responsibility" for such work conditions "notwithstanding" any other statements or representations from El Paso. Did the court of appeals err in nullifying this language?

2. In a construction contract dispute between private parties, are the Texas courts "bound by the holding of the United States Supreme Court in *Hollerbach v. United States*, 233 U.S. 165, 34 S.Ct. 553 (1914)"?

INTRODUCTION

This is a construction contract case that involves a small number of key clauses. The court of appeals acknowledged the risk-shifting clauses of the contract but refused to enforce them because it felt that doing so would give those clauses "controlling effect" over a due diligence clause. **Tab 3** at *17. The court simply felt that parties cannot draft one set of clauses to override another. *See id.* ("No single provision is given such controlling effect.").

If the majority felt that ignoring the risk-shifting clauses was equitable, it erred. The only fair result is to enforce the contract. This case looks suspiciously like a case of a contractor who submits an artificially low bid to win the job, with the goal of making a bigger profit later by asking for extra money after the work. El Paso received nine bids for the work. The average was $8.10 million. The high bid was for over $15 million. MasTec's bid came in at $3.69 million. El Paso urged MasTec to double-check its bid, but MasTec held firm. It now wants another $4.75 million.

At any rate, the key facts are purely contractual. The contract spells out which side bears the risk of the kinds of cost overruns that occurred here:

1. Due diligence. There is language in which El Paso commits to having "exercised due diligence in locating foreign pipelines and utility line crossings." [Tab 6 at Specs. LP-5 & LP-17].

2. Risk-shifting clauses. But overriding language states that "**notwithstanding**" anything else in the contract or in any representations from El Paso, MasTec assumes full responsibility for "**subsurface conditions**" and "**obstructions**" and "**all risks in connection therewith**." [*Id.* at Arts. 7.1(e) & 8.1(a)(7)].

These clauses are the facts that matter most, so our statement of facts will be short.

STATEMENT OF FACTS

El Paso bought an old underground pipeline that runs from near the Astrodome to Corpus Christi.[1] It was built in the 1940s as a "war emergency pipeline" to transport petroleum from the refineries around Corpus Christi to "Air Force bases and such."[2] Given the pipeline's age and shallow depth, El Paso set out to rebuild it.

El Paso hired surveyors to locate the pipeline and any underground crossings.[3] Then El Paso sought bids from pipeline construction companies to do the actual work. The low bid came from MasTec, who wanted to expand its business.[4]

The parties knew that there would be things beneath the ground that no one could see until the work was underway. The "great risk" in construction is said to be the underground surprise.[5] For this reason, some in the industry now use a standard clause that allocates most of this risk to the owner.[6] But MasTec and El Paso chose not to allocate this risk to El Paso. They allocated "all risks" of underground surprises to MasTec. They did this in Articles 7.1(e) and 8.1(a)(7). *See* **Tab 6**. Those sections state that "notwithstanding" anything else El Paso may have said, MasTec assumed complete responsibility for such conditions and bore "all risks in connection therewith."

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[1] 6 RR 36, 165.
[2] 6 RR 36.
[3] 6 RR 44; *see also* 6 RR 34, 155.
[4] DX 9; 3 RR 65.
[5] *P.T. & L. Constr. Co. v. State of N.J., Dep't of Transp.*, 531 A.2d 1330, 1334 (N.J. 1987) ("[T]he great risk, for bidders on construction projects, [is] adverse subsurface conditions."); *see also Youngdale & Sons Constr. Co. v. United States*, 27 Fed. Cl. 516, 527 (1993); Philip L. Bruner & Patrick J. O'Connor, Jr., BRUNER AND O'CONNOR ON CONSTRUCTION LAW § 14:1 (2009).
[6] *See* BRUNER & O'CONNOR, §§ 14:1, 14:45, 14:46.

This allocation of underground risk to MasTec was no accident. El Paso had dealt with MasTec's principal, Mr. White, on a prior job. There he had grossly underbid a piece of work in order to get hired, only to smuggle in improper charges later.[7] El Paso worried that he might try it again. El Paso offered him the chance to withdraw his bid, suggesting that he may not have considered all of the relevant costs. Mr. White refused to withdraw his bid.[8] While El Paso ultimately took his offer, it designed the contract to make sure that the previous problem did not recur.[9]

Predictably, MasTec found underground surprises. When it could not convince El Paso to pay extra money for the surprises, MasTec sued for breach of contract. It argued that El Paso had promised "due diligence" in locating all the foreign crossings, and that El Paso had not disclosed enough of those crossings. El Paso countered that the "due diligence" clause is trumped by the "all risks" and "notwithstanding" language.

The jury found for MasTec and assessed $4,763,890 in damages, but the trial court granted El Paso's motion for JNOV based on the contract's allocation of the risk. *See* **Tabs 1 & 2**. The trial judge explained her reasoning in the final judgment:

> The Court finds that the Contract at issue in this case … is clear and unambiguous. This Contract allocates the risk of any additional cost incurred because of foreign pipeline crossings to Mastec. The Court therefore grants Enterprise's motion (a) for judgment non obstante veredicto and (b) to disregard certain jury answers.

Tab 2 at 2.

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[7] *See* 6 RR 38-64.
[8] 6 RR 58.
[9] 6 RR 38-39, 59.

The court of appeals (2-1) overturned the JNOV. The Majority felt that the "due diligence" clause is not trumped by the "all risks" and "notwithstanding" language. *See* **Tab 3**. Justice Jennings disagreed. *See* **Tab 4**. He felt that "the parties expressly agreed in no uncertain terms that MasTec bore 'all risks' of dealing with unanticipated conditions." *Id.* at *26. The court of appeals gave three notable reasons for disagreeing with Justice Jennings about the enforcement of the contract:

1. It felt that no clause in a contract may ever override another one. *Id.* at *17.

2. It felt that although the risk-shifting clauses refer to "subsurface conditions," "substructure conditions," and "obstructions," none of that matters. The court maintained that "these provisions do not expressly include underground foreign crossings." *Id.*

3. It felt that it was "bound" by some pre-*Erie* federal common law instead of this Court's decisions in *Lonergan* and *Shortall*. *Id.* at *22.

The court then denied rehearing en banc, over the objection of two additional dissenters.

SUMMARY OF THE ARGUMENT

This case is *Enterprise Leasing* all over again. There this Court held that Justice Jennings was right to dissent, and he is as right today as he was back then, because the basic point remains the same. Just as "**all losses**" in *Enterprise Leasing* meant all losses, "**all risks**" should mean all risks. *See Enterprise Leasing Co. v. Barrios*, 156 S.W.3d 547, 549 (Tex. 2004) (*per curiam*) ("'all losses' means all losses").

The contract reinforces this idea of assuming "all risks" when it says that this risk allocation trumps "anything in this Contract or in any representations" made by El Paso. The contract says that this risk allocation prevails "notwithstanding" anything else.

The court of appeals felt that "all risks" does not really mean "all risks" because that result would nullify the due diligence clause. But the court of appeals committed the same error that it sought to avoid, because it nullified the "all risks" and "notwithstanding" language. By definition, a "notwithstanding" clause acts to override some other clause. That is its point. In failing to keep "all" risks on MasTec, the court of appeals made the same mistake that required this Court to reverse in *Enterprise Leasing*.

Reversing on the basis of *Enterprise Leasing* would kill two birds with one stone. First, it would restore certainty to construction contract law. Second, it would prevent the spread of the mistaken notion that state courts are "bound" by pre-*Erie* federal common law instead of Texas caselaw. The final word on Texas contract interpretation belongs to this Court, not the U.S. Supreme Court. Owners and contractors alike have structured their contracts in reliance on Texas law—not pre-*Erie* federal common law—governing risk allocation. The decision below throws such contracts into question. Because there are so many of these kinds of contracts, and because an able court of appeals found itself deeply divided (2-1 and 5-3) over such basic issues, this Court should step in.

ARGUMENT

This Court has been vigilant in upholding freedom of contract and in requiring lower courts to enforce the parties' bargain. When parties make a contract that allocates the risk between them, the courts should honor that bargain. This tenet of contract law had seemed to be well settled, but the divided decision of the court of appeals indicates potential confusion.

The Court should not let the court of appeals undermine certainty in contract law. There are countless construction contracts that place the risk on one side or the other. The court of appeals should not be permitted to create havoc in that arena.

I. The court of appeals undermined freedom of contract in a way that threatens the interpretation of many construction contracts.

Texas has a "strong public policy in favor of preserving the freedom of contract." *Fairfield Ins. Co. v. Stephens Martin Paving, LP*, 246 S.W.3d 653, 664 (Tex. 2008). This lets parties allocate risk: "Freedom of contract allows parties to bargain for mutually agreeable terms and allocate risks as they see fit." *Gym-N-I Playgrounds, Inc. v. Snider*, 220 S.W.3d 905, 912 (Tex. 2007).

MasTec assumed the risk under the contract. There is no escaping the words "**all risks**" in Article 7.1(e) of the contract. There MasTec warranted:

> That [it] . . . has fully acquainted itself with the site, including . . . soil structure, subsurface conditions, obstructions and all other conditions pertaining to the Work and has made all investigations essential for a full understanding of the difficulties which may be encountered . . . and that anything in this Contract or in any representations, statements or information made or furnished by the Company or any of its representatives notwithstanding, [MasTec] assumes full and complete responsibility for any such conditions pertaining to the Work . . . and **all risks in connection therewith**.

Tab 6 at art. 7.1(e) (emphasis added) (art. 8.1(a)(7) is similar).

Enterprise Leasing stands for the proposition that "'all losses' means all losses," so one would expect the court of appeals to explain why "all risks" does not mean "all risks." *See Enterprise Leasing*, 156 S.W.3d at 549. The court of appeals quotes the "all risks" language. *See* **Tab 3** at *15. Yet it never discusses what that language means.

The majority admitted that the "all risks" language covered the risk of running into "substructure conditions" and "obstructions." **Tab 3** at *17 (quoting Article 8.1(a)(7)). But it failed to note that Article 7.1(e) speaks of "subsurface conditions" and "obstructions." The majority then concluded that "these provisions do not expressly include underground foreign crossings." *Id.* That holding is erroneous. An underground foreign crossing **is** a subsurface condition or obstruction.

In fact, even MasTec agrees that foreign crossings are included in the risks that Article 7.1(e) has in mind. Its vice-president admitted it on the stand. 4 RR 105. The court of appeals is quite alone in thinking that foreign crossings underground do not qualify as "substructure conditions," "subsurface conditions," or "obstructions."

But if all of this contractual risk-shifting language were not enough, the inclusion of the word "**notwithstanding**" should have clinched the matter. That is a key word that should have compelled a take-nothing even if *Enterprise Leasing* did not. MasTec accepted all risks of underground surprises "**notwithstanding**" what El Paso may have said anywhere else in the contract.

The court of appeals thought that enforcing the "notwithstanding" would be a bad thing because this would override other contractual terms. We agree that enforcing the "notwithstanding" would override other terms, but we do not agree that this would be a bad thing. If parties draft a contract that makes section X control in certain instances, "notwithstanding" anything in section Y, they have every right to do so. This is not a case with any fraud. Nobody alleges trickery or subterfuge. El Paso urged MasTec to double-check its bid to make sure. MasTec made its bargain with its eyes open.

Because MasTec was just entering the pipeline construction business, perhaps it saw a lower profit margin on this job as part of the cost of breaking into this new business—*i.e.*, a loss leader. *See* 4 RR 159, 167. Or perhaps it planned all along to low-bid the job and ask for more money later. But it does not matter. Either way, MasTec ought to keep its promises.

The court of appeals felt required to "presume" that parties want every clause to have effect. **Tab 3** at *14. But this contract makes it unnecessary to presume. The contract shows that the parties wanted the risk on MasTec notwithstanding what El Paso may have said anywhere else. *Cf.* *In re United Servs. Auto. Ass'n*, 307 S.W.3d 299, 311 (Tex. 2010) (courts construe statutes to harmonize with other laws unless the Legislature indicates otherwise with phrases such as "notwithstanding any other law").

Now, if the parties had never said "notwithstanding," the case might be different. But when parties "use the clause 'notwithstanding anything to the contrary contained herein' in a paragraph of their contract, they contemplate the possibility that other parts of their contract may conflict with that paragraph, and they agree that this paragraph must be given effect regardless of any contrary provisions of the contract." *Helmerich & Payne Int'l Drilling Co. v. Swift Energy Co.*, 180 S.W.3d 635, 643 (Tex. App.—Houston [14th Dist.] 2005, no pet.).

The court offers various reasons why the "notwithstanding" should be ignored. None of these reasons will do. First, the court says that no "single provision" can have "controlling effect." **Tab 3** at *17. But nothing could be more wrong. Contracting parties have every right to agree that one clause will trump another. When a court honors

the parties' decision that one clause will apply "notwithstanding" some other clause, the court is not making the latter meaningless. It is carrying out the wishes of the parties. Anything else would render the word "notwithstanding" meaningless.

This point leads to the obvious question: If "notwithstanding" truly means that some other clause gets overridden, why did the parties leave the other clause there at all? The answer is found in the Restatement, which recognizes that parties often stipulate that certain words in a contract may have business purposes but not legal consequences:

> The preference for an interpretation which gives meaning to every part of an agreement does not mean that every part is assumed to have legal consequences. Parties commonly direct their attention to performance rather than breach, and it is enough that each provision has meaning to them as a guide to performance. Stipulations against particular legal consequences are not uncommon. Thus it is not unusual to define the intended performance with precision and then to provide for tolerances within which variation is permitted.

RESTATEMENT (SECOND) OF CONTRACTS § 203 cmt. b (1981).

That is what happened here. El Paso made a representation about due diligence, but the parties agreed that the ultimate risk fell on MasTec notwithstanding that representation. They had every right to fine-tune their contract by allocating "all risks" to MasTec, "notwithstanding" the provision about due diligence.

Second, the court says that it would be unreasonable, inequitable, and oppressive to give effect to the "notwithstanding" clause. **Tab 3** at *18 (citing *Frost Nat'l Bank v. L & F Distributors, Ltd.*, 165 S.W.3d 310, 312 (Tex. 2005)). MasTec never raised this argument, and with good reason. The law endorses risk allocation: "Freedom of contract allows parties to bargain for mutually agreeable terms and allocate risks as they see fit." *Gym-N-I Playgrounds, Inc. v. Snider*, 220 S.W.3d 905, 912 (Tex. 2007).

There is nothing "unreasonable" or "oppressive" about sophisticated parties allocating risks like this in a construction contract. It happens every day. It was quite reasonable for the parties to allocate the risk to MasTec. What would be unreasonable (and thus contrary to *Frost Nat'l Bank*) would be to let MasTec get away with bidding this job on the cheap, only to double its money afterwards, the way the respondent in *Frost Nat'l Bank* tried to get away with the leased trucks for next to nothing.

II. The court of appeals' mistaken adherence to pre-*Erie* federal common law—in opposition to the settled law of Texas—may spread unless corrected.

The court of appeals held that it could not give effect to the "all risks" language because its decision was controlled by *Hollerbach v. United States*, 233 U.S. 165 (1914). *See* **Tab 3** at *22. The court noted that *Hollerbach* "was decided on similar facts and is cited by MasTec." *Id.* Regardless of whether the facts are similar, the case does not apply. First, *Hollerbach* is a pre-*Erie* decision that is not binding on the courts of any state. Second, *Hollerbach* runs contrary to the rule in Texas. It creates a background rule about which side bears the risk in cases where the contract does not say. It presumptively puts the risk on the owner, whereas Texas puts the risk on the contractor. *See Lonergan v. San Antonio Loan & Trust Co.*, 101 Tex. 63, 104 S.W. 1061, 1065-66 (1907).[10] Finally, and in any event, this dispute about the applicable background rule is

[10] *Hollerbach* makes the owner the guarantor of any specifications given to a contractor. *See Hollerbach*, 233 U.S. at 172. This rule was reaffirmed in *United States v. Spearin*, 248 U.S. 132, 136 (1918). But this Court refused to adopt the federal rule as Texas law: "The ground upon which recovery was allowed in [*Spearin*] is not recognized in our state." *See City of Dallas v. Shortall*, 131 Tex. 368, 114 S.W.2d 536, 540 (1938). Rather, this Court reaffirmed that the controlling rule in Texas was the *Lonergan* rule. *Id.*

insignificant. *Hollerbach* and *Lonergan* agree that parties are free to allocate this risk. *See Lonergan*, 104 S.W. at 1066 (to modify the background rule "there must be found in that contract such language as will justify" that is what the parties intended).

Yet the court of appeals ignored the parties' allocation of the risk. It seemed confused by language in some of the federal cases that originated in *Hollerbach*. The court of appeals' adherence to old federal cases was error. It should have obeyed this Court's decisions in *Lonergan* and *Shortall*. Those Texas cases hold that the default rule places the risk on the contractor while allowing the parties to alter that default allocation of the risk by addressing it expressly in their contract. Because the parties expressly allocated the risk of underground surprises to MasTec, El Paso is not responsible for MasTec's underbidding on the project.

CONCLUSION & PRAYER FOR RELIEF

Review is justified for several reasons. First, the decision below conflicts with this Court's decision in *Enterprise Leasing*. Second, the splitting of the court of appeals into (2-1) and (5-3) blocks shows that there is confusion in this important area of the law. Third, the case is important because construction contracts regularly use similar clauses to allocate the risk of underground surprises. Fourth, the decision below resurrects a pre-*Erie* rule and casts a cloud over the viability of this Court's *Lonergan* line of cases. Finally, a take-nothing judgment would be fair and just. MasTec bid the job for half of what its competitors bid; when El Paso urged MasTec to take another look and revise the bid, MasTec stood its ground and signed the contract. MasTec should keep its promise.

The judgment should be reversed and the trial court's JNOV should be reinstated.

Respectfully submitted,

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CERTIFICATE OF SERVICE

A true and correct copy of the above and foregoing Petition for Review was properly forwarded to all counsel of record in accordance with the Texas Rules of Appellate Procedure, on September 16, 2010, by certified mail, return receipt requested, addressed as follows:

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APPENDIX TO PETITION FOR REVIEW

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