Supreme Court of Texas
March 6, 2015

KCM Fin., LLC v. Bradshaw
No. 13-0199
Case Summary written by Jeri Leigh McDowell, Staff Member.

Justice Guzman delivered the opinion of the Court.

In this case, an oil and gas dispute raised the issue of the duties owed to a non-participating royalty interest holder (also known as a non-executive interest holder) by an executive-right holder. In 1960, Ms. Betty Lou Bradshaw's parents executed two deeds, which conveyed all surface and mineral interests in a large tract of land in Hood County known as Mitchell Ranch. The deeds reserved to Ms. Bradshaw's parents and their heirs an "undivided one-half [interest] of any future royalty and limited the executive right by mandating that any such royalty be 'not less than' one-eighth." At the time of the conveyance, a one-eighth royalty interest was the standard for fair dealing.

As of July 2005, the owner of the surface and mineral estate interests in Mitchell Ranch had not developed the tract. A few months later, however, an individual named Humphreys approached the owner to negotiate the purchase of the entire tract, including the mineral estate. No mention of royalty appeared in the ensuing contract. Humphreys assigned his purchased interest in the Mitchell Ranch to Texas Shepco, LP, a limited partnership controlled by R.J. Sikes. Sikes then formed a new limited liability company, now called KCM Financial, LLC, and named himself the managing member. Humphreys in turn terminated the assignment to Texas Shepco and re-assigned his interest in the Ranch to KCM Financial. In negotiating the closing of the contract, both KCM and Humphreys became increasingly concerned with Bradshaw's royalty interest. Specifically, the parties exchanged several communications discussing the various ways by which they could structure the arrangement, noting at several points that Bradshaw, as a non-executive interest holder, would be entitled to no bonus money from the development of the land by a lessee.

The negotiations eventually led to KCM closing the deal. KCM then turned around and "sold the surface estate to Range Resources and executed a mineral lease with Range Production I, L.P." Under the terms of the lease, KCM reserved for itself both a one-eighth royalty and a $7,505 bonus per acre. Bradshaw retained her one-sixteenth interest in gross production under the terms of the 1960 lease.

At the time of this arrangement, evidence showed that the standard for a non-executive interest holder's royalty was double what KCM had agreed to in its mineral-lease with Range. Additionally, the bonus per acre grossly exceeded the standard for bonuses in Hood County. Accordingly, Ms.

Bradshaw sued, alleging that KCM, as the executive-interest holder, had breached his fiduciary duty to her, as the non-executive interest holder. She further alleged that Range, as lessee, had conspired and aided and abetted KCM's breach. Ms. Bradshaw also brought fraudulent transfer claims against other Royalty holders that KCM had transferred an interest to in the prior negotiations, and sought the imposition of a constructive trust on the proceeds of the royalty interest. The defendants moved for summary judgment on all counts, which the trial court granted without opinion. Ms. Bradshaw appealed.

The court of appeals reversed and remanded on all claims except for those regarding the individual royalty owners. The court of appeals held that KCM owed Ms. Bradshaw a fiduciary duty of the "utmost good faith" and that material fact issues precluded that issue from being decided on summary judgment. In the count against Range, the court noted that KCM's breach of fiduciary duty underlay this issue, preventing its decision on summary judgment. The defendants appealed.

Issue: (1) Did KCM breach the duty it owed Ms. Bradshaw? (2) Can a lessee by liable under the theories of conspiracy and
aiding and abetting for an executive-interest holders breach of fiduciary duty?

The Texas Supreme Court affirmed the appellate court's judgment as to the breach of duty claims against KCM and remanded the issue to the trial court for further determination. On the issues of conspiracy, aiding and abetting, fraudulent transfer, and constructive trust, the Court reversed the appellate court, granting a take-nothing judgment on these claims. In evaluating the breach of duty claim, the Court noted that although "[a]n executive owes a non-executive a duty that prohibits self-dealing," the executive is not required to place its own interests below that of the non-executive. Instead, the duty of "utmost good faith and fair dealing" only requires that the executive "acquire for the non-executive every benefit that he exacts for himself." As such, the controlling question was not whether the executive engaged in some sort of self-dealing, but rather whether "the acts of self-dealing [] unfairly diminished the value of the non-executive interest."

Applying the facts at hand, the Court reasoned that while the availability of a higher interest rate could give insight into the whether or not the executive breached its duty, it was not dispositive. Looking to the record, the Court noted that when weighing the evidence in the light most favorable to Ms. Bradshaw, some evidence existed of KCM engaging in improper self-dealings to the detriment of Ms. Bradshaw. As a result, the court remanded the issue for further determination by an appropriate trier of fact.

Turning next to the conspiracy and aiding and abetting charge, the Court noted that Range, as a lessee, owed no independent duty to Ms. Bradshaw. This lack of a fiduciary relationship combined with the arms-length nature of the lease transaction precluded a finding of liability. The

Court reasoned that allowed a derivative-liability claim to proceed against a lessee would open the floodgates, requiring both sides in a negotiation to balance their own interests against that of the non- executive when executing a deal. Such a result, the Court reasoned, would be both nonsensical and contrary to the scope of the fiduciary relationship.

Turning finally to the constructive trust and fraudulent transfer charges, the court noted that the defendants conclusively negated at least one element of both theories. With the constructive trust claim, Ms. Bradshaw failed to prove her entitlement to the royalty funds. The Court reasoned that while a constructive trust might, from an accounting perspective, make Ms. Bradshaw whole, that was not its purpose. Regarding the fraudulent transfer claim, the Court noted that Ms. Bradshaw failed to present evidence that KCM Financial was insolvent at the time of the transfers to the Royalty Owners. Without proving insolvency, Ms. Bradshaw could not meet one of the required elements of the fraudulent transfer claim.

The Fredericksburg Care Co., L.P., v. Lira
No. 13-0577
Case Summary written by Tara Parker, Staff Member.

Per Curium.

The issue in this case is whether the McCarran Ferguson Act (MFA), 15 U.S.C. §§ 1011–15, exemptions Texas Civil Practice Remedies Code § 74.451 from being preempted by the Federal Arbitration Act, 9 U.S.C. §§ 1–16. This case was consolidated with two other cases with identical issues and opinions. The Court held that the MFA exemption from preemption applied to § 74.415 of the Texas Civil Practice Remedies Code. That section "was not a law enacted for the purpose of regulating the business of insurance and thus does not qualify for the MFA exemption from preemption."

The Court found that the trial court should not have denied the motion to compel arbitration. The judgment of the court of appeals is reversed, and the case remanded to the trial court.

Fredericksburg Care Co., L.P. v. Perez
No. 13-0573
Case Summary written by Julio Montiel, Staff Member.

Green, J., delivered the opinion of the Court.

Facts: Beneficiaries of Elisa Zapata, a deceased patient of the Fredericksburg Care Company, L.P. (Fredericksburg), sued Fredericksburg, a nursing home "that specializes in providing long-term care to patients," for

negligent care and wrongful death. Prior to her admission, she signed an agreement that contained an arbitration clause, and Fredericksburg moved to compel arbitration under that clause. The parties stipulated that the arbitration agreement did not comply with Tex. Civ. Prac. & Rem. Code § 74.451 (a), which requires conspicuous, written notice to patients of their agreement to arbitrate a health care claim.

Still, Fredericksburg argued that the Federal Arbitration Act (FAA) preempts § 74.451 because the transaction between the patient and provider involved interstate commerce. For Fredericksburg, despite the agreement's non-compliance with § 74.451, the arbitration agreement was still valid. The Beneficiaries argued that § 74.451 was exempt from preemption because of the McCarran-Ferguson Act (MFA), which exempts state statutes enacted for the purpose of regulating the business of insurance. For the Beneficiaries, the purpose of § 74.451 was to regulate the business of insurance, which thereby made it exempt. The trial court denied Fredericksburg's motion, making the arbitration clause unenforceable. After, Fredericksburg filed an interlocutory appeal. The appellate court affirmed because it looked at the legislative purpose behind predecessor legislation and ruled that, like the predecessor legislation, § 74.451 was intended to regulate the business of insurance. As a result, the appellate court held that § 74.451 was exempt from preemption. Issue: Does the MFA apply to § 74.451 and therefore exempt this state law from federal preemption? Holding: The MFA does not apply to § 74.451 because the statute provision is not a law enacted for the purpose of regulating the business of insurance. Federal law preempts this statute.

The Supreme Court of Texas noted that preemption under the FAA results when state provisions contain an additional element, which leads to a conflict between federal and state law. Although the Court assumed that the FAA applied in this case, it held that § 74.451 was preempted because it had additional requirements in direct conflict with the FAA.

As to exemption under the MFA, the Court began by looking at United States Supreme Court precedent, which established the following three part test for state laws that regulate the business of insurance: (1) the federal law does not explicitly relate to the business of insurance, (2) the state law was meant to regulate the business of insurance, and (3) the specific federal law serves to "invalidate, impair, or supersede" the state law. For the MFA to apply, all parts must be satisfied. For the first part, there is no dispute that the FAA does not explicitly relate to the business of insurance. For the third part, the Court had already concluded that the FAA conflicted with § 74.451, which satisfied this element.

As to the second part, the Court held, consistent with *U.S. Department of Treasury v. Fabe*, that the purpose of a specific provision of a statute must be determined based on the whole act, not the specific provision in isolation. Thus, the purpose of § 74.451 would have to be determined based on the purpose behind all of Chapter 74. The Court also found the MFA's focus on

the relationship between the insurer and the policyholder relevant to the analysis. Along with this focus, the Court noted three criteria, under *Union Labor Life Insurance Co. v. Pireno*, to evaluate whether a practice equates to "business of insurance" to help clarify if in fact a law was meant for the purpose of regulating the business of insurance. The criteria are whether the practice (1) transfers or spreads the policyholder's risk, (2) forms an important part of the policy relationship between the insurer and insured, and (3) involves solely entities in the insurance industry. Then, the Court considered Chapter 74's legislative history, ultimately, establishing that the law was enacted to impose tort reform to limit health care liability claims and thereby make health care more affordable in Texas. This purpose of indirectly lowering premiums however was too tenuous to fit within the definition of the business of insurance because it would exceed the scope and focus of the MFA. The Court then applied a broader test under *Fabe*, which involves "laws that possess the end, intention, or aim of adjusting, managing, or controlling the business of insurance." Under Chapter 74, once the parties agree to a premium, the law does not adjust, manage, or control the business of insurance because it has no bearing on the performance of a contract. Therefore, contrary to the court of appeals, the Court held that Chapter 74 did not satisfy this broader test. Consequently, the Court concluded that Chapter 74, as a whole, was not intended for the purpose of regulating the business of insurance because lowering premiums is not a practice that equates to the business of insurance under the three *Pireno* factors.

Although Chapter 74 altogether was not meant to regulate the practice of insurance, the Court reasoned, as in *Fabe*, that it was necessary to analyze the purpose of the specific provision in question—§ 74.451. The Court interpreted *Fabe* to mean that courts must look to the specific provision that conflicts with federal law to decide if the conflicting provision was meant to regulate the business of insurance. While keeping in mind the overall statutory framework of Chapter 74, the Court held that § 74.451 was an arbitration statute of specific applicability, applying to agreements to arbitrate healthcare liability claims and not to insurance contracts. The pre-admission agreement was not between an insurance company and a policyholder, but a separate agreement between a patient and a healthcare provider for services other than insurance, which would not fall within the definition of the business of insurance. § 74.451 potentially protects someone who is insured "but it does not protect that person in his capacity as a part to a contract of insurance." Also, for the Court, parties cannot invoke the MFA's protection through particular terms in an insurance contract because the MFA focuses on the purpose behind the particular law in question and not the agreement. Moreover, § 74.451 was not intended to protect persons who purchase insurance policies nor does it have any bearing on contractual performance. Therefore, the statute's regulated practice—agreements to arbitrate healthcare liability claims—would not satisfy the *Pireno* test. In

conclusion, the Court found that § 74.451 was not meant to regulate the practice of insurance, which would not allow for exemption from preemption under the MFA. The Court reversed the court of appeals and held that Fredericksburg's motion to compel arbitration should have been granted because the FAA would control.

Williamsburg Care Co., L.P. v. Acosta
No. 13-0576
Case Summary written by Justin Nail, Staff Member.

Per Curiam.

Plaintiffs in the original case were former residents of Princeton Place Rehabilitation and Healthcare, a San Antonio-based nursing and long-term care facility managed by The Williamsburg Care Company. The plaintiffs sued alleging, among other things, gross negligence and abuse. Williamsburg moved to compel arbitration under the individual residents' contracts, under the Federal Arbitration Act. These arbitration agreements, however, did not comport with section 74.451 of the Texas Civil Practices and Remedies Code. Section 74.451 requires an arbitration agreement between health care providers and their patients to have a 10-point font, boldfaced notice and requires that same agreement to contain a signature from the patient's attorney. Neither of these provisions was met. The plaintiffs contended that the FAA did not preempt section 74.451 because the Texas law regulates insurance, and the McCarran-Ferguson Act (MFA) protects those laws from preemption by the FAA. The trial court denied Williamsburg's motion to compel arbitration, and the court of appeals affirmed, holding that section 74.451 was enacted for insurance regulation purposes, was covered by the MFA, and was protection from preemption.

Issue: Whether the MFA exempted section 74.451 from FAA preemption as a law enacted to regulate the business of insurance.

The court of appeals below consolidated this case with two others, *Fredericksburg Care Co. v. Lira*, and *Fredericksburg Care Co. v. Perez*, which contained similar complaints and legal questions. In its ruling in *Perez*, the Texas Supreme Court held that the purpose of section 74.451 of the Texas Civil Practice and Remedies Code was not to regulate the business of insurance, and therefore, section 74.451 was not protected from FAA preemption under the McCarran-Ferguson Act. Because the trial court did not grant Williamsburg's motion to compel arbitration, it erred. The Court found that its rulings in *Perez* and *Lira* also applied to the facts above, reversed the rulings of the trial court and court of appeals, and remanded to the trial court.