

NOTE: CONTRACTUAL LIABILITY OF PIPELINES  
FOR DAMAGES CAUSED BY GAS SUPPLY CURTAILMENTS:  
*TEXASGULF, INC. V. UNITED GAS PIPELINE CO.*

[T]he industrial user may be able to say: Given the pickle created by the pipeline company, what the FPC did was lawful and proper as to actual subsequent rationing of the limited supply of gas, but the pipeline company is liable in damages because of the way it put us all in the pickle.<sup>1</sup>

The natural gas shortages of the early 1970s caught many interstate pipeline companies by surprise and endangered their ability to meet the obligations of their gas supply contracts. As a result, many pipeline companies were forced to apply for relief to the Federal Power Commission.<sup>2</sup> FPC relief came in the form of a policy statement;<sup>3</sup> pipeline companies thereafter filed revised tariffs, which provided for curtailment of service to pipeline customers.<sup>4</sup> Some gas customers then brought suit asking for specific performance of their gas contracts.<sup>5</sup> When those cases were dismissed on jurisdictional grounds, some gas customers filed suit against the pipeline companies for breach of contract, claiming damages amounting to billions

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<sup>1</sup>*Monsanto Co. v. FPC*, 463 F.2d 799, 808 (D.C. Cir. 1972) (the *Monsanto* Court was not ruling on liability, but was defining the "negligent breach of contract" issue to be decided at a later date).

<sup>2</sup>Jurisdiction of the FPC is established in 15 U.S.C. § 717(b) (1982) (commonly referred to as Section 1(b) of the Natural Gas Act). Section 1(b) provides that:

The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

In 1977 the functions of the FPC were transferred to the Federal Energy Regulatory Commission. See 42 U.S.C. § 7172(a)(1982). The FPC and the FERC will be referred to interchangeably as "the Commission" throughout the remainder of this note, unless greater specificity is required.

<sup>3</sup>In April of 1971, the FPC issued Order No. 431, codified at 18 C.F.R. § 2.70 (1985), a policy statement which ordered jurisdictional pipeline companies to take "all steps necessary for the protection of as reliable and adequate service as present [natural gas] supplies and capacities will permit . . ." Order No. 431, 45 F.P.C. 570, 571 (1971). To achieve this objective, the FPC ordered jurisdictional pipelines to file revised tariffs "setting forth a curtailment plan to effectuate the instant policy or state that the curtailment program, if any, currently on file will effectuate this policy." *Id.* at 572.

<sup>4</sup>For succinct discussions of natural gas supply curtailments, see Mogel, *Food, Fuel and Federal Curtailment Regulation*, 56 CHICAGO-KENT LAW REV. 789 (1980); Pierce, *NATURAL GAS REGULATION HANDBOOK*, 99-106 (1980); Muys, *Federal Power Commission Allocation of Natural Gas Supply Shortages: Prorating, Priorities, and Perplexity*, 20 ROCKY MTN. MIN. L. INST. 301 (1975).

<sup>5</sup>See, e.g., *Virginia v. Tenneco, Inc.*, 538 F.2d 1026 (4th Cir. 1976); *Atlanta Gas Light Co. v. FPC*, 476 F.2d 142 (5th Cir. 1973).

of dollars.<sup>6</sup> One of the cases, *Texasgulf, Inc. v. United Gas Pipe Line Co.*,<sup>7</sup> has been decided in favor of a gas customer whose supply was curtailed. In *Texasgulf*, liability was predicated not on the fact that the interstate pipeline curtailed gas service to its customer in the face of a shortage, but rather on the fact that the pipeline was responsible to a great extent for the conditions leading to the shortage and subsequent curtailment.

The *Texasgulf* decision is the first federal court decision in which a natural gas pipeline, delivering gas under a Commission-approved curtailment program, has been held liable for breach of contract for causing the events that precipitated the breach. Since breach of contract claims against United Gas Pipe Line Co. (and other interstate pipelines in analogous situations) total billions of dollars, it is important to study the factual setting and the reasoning of the court in the *Texasgulf* case.

In *Texasgulf*, the District Court for the District of Columbia addressed three very important issues: whether a federal court has authority to hear issues which are within the primary jurisdiction of a federal agency but have not been ruled on by that agency; whether a pipeline's filed tariff, which provides a mandatory curtailment program, can shield the pipeline from liability for breach of contract when the pipeline curtails service to a direct user below minimum contract amounts; and the nature of the standard of care that an interstate pipeline owes to a direct customer, and how that standard of care may be breached.

#### I. BASIS FOR THE DISPUTE BETWEEN TEXASGULF AND UNITED GAS PIPE LINE

In 1967, Texasgulf, Inc. started a sulphur-mining operation and needed a firm supply of natural gas. Texasgulf planned on using the "frasch" process for extracting sulphur from its Bully Camp dome, located in the coastal marshes forty miles southwest of New Orleans, Louisiana.<sup>8</sup> Texasgulf considered natural gas the

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<sup>6</sup>In *United Gas Pipe Line Co.*, 20 F.E.R.C. ¶ 63,070 (1982), an administrative law judge stated:

This case . . . is an outgrowth of the shortage of natural gas on the United Gas Pipe Line Company system which resulted in the curtailment of deliveries by it beginning in the 1970-71 winter heating season. Nor surprisingly, curtailment made United's customers very unhappy — particularly six direct customers . . . who, between 1971 and 1975, brought suit against United in various state and federal courts, for themselves alone and not on behalf of all curtailed customers as a class, to recover damages amounting to \$1,973,820,662, which they claim to have suffered as a result of United's curtailments.

*Id.* at 65,284. Some of the claims against United have been tried or settled. "So far, United has settled four curtailment damage suits by total payments in excess of \$112 million. At present, United faces potential judgements which could involve as much as \$270 million." *United Gas Pipe Line Co.*, 31 F.E.R.C. ¶ 61,336 at 61,773 (1985).

<sup>7</sup>610 F.Supp. 1329 (D. D.C. 1985) [hereinafter cited as *Texasgulf*]. This *Memorandum on Liability* was handed down on June 4, 1985.

<sup>8</sup>The U.S. District Court described the frasch process as utilized by Texasgulf:

Under the frasch process, water is superheated to about 330 degrees Fahrenheit under high pressure and is injected through pipes into the crystallized sulphur deposits. At the Bully Camp mine, the molten sulphur was transported after extraction by small barges to storage tanks at a shore base six miles to the north of the mine. Large barges would then transport the sulphur to Texasgulf's headquarters or to its customers for further processing. Gas heat was used for the entire process of extraction and storage until the sulphur was loaded onto the large barges, which heated with diesel fuel.

*Texasgulf*, 610 F.Supp. at 1333 n.8.

only practical energy source for the offshore location. Because of the nature of the Frasch process, Texasgulf sought one large supplier to provide a continuous source of natural gas. Texasgulf negotiated for natural gas first with Texaco and then with United Gas Pipe Line. As low bidder, United obtained the contract to supply gas to the Texasgulf mine. At its own expense, United constructed extensions of its gas pipeline system in order to serve Texasgulf. United then became the only available gas supplier upon which Texasgulf could rely to supply the mine.<sup>9</sup> United was aware of the importance of maintaining constant, uninterrupted delivery to Texasgulf's mine.<sup>10</sup> During the gas sales negotiations, United repeatedly represented that it "already had 'a supply of gas available' and was 'willing to sell and deliver' Texasgulf's full requirements."<sup>11</sup> Texasgulf made no independent investigation of United's gas reserves, but instead entered the contract relying entirely on United's representations as to its current gas reserves and on the fact that United was the second largest pipeline company in the United States and a major gas supplier in Louisiana.<sup>12</sup>

According to the gas sales agreement, which was drafted by United and executed by the parties on October 27, 1967, United was to supply up to 10,100 Mcf of natural gas per day over a continuous twenty-year period. The contract contained two clauses which limited United's otherwise firm commitment to deliver. The limiting clauses were Article VIII, *Force Majeure*, which contained an exculpatory clause, effective only if performance on the contract became impossible due to causes which the non-performing party, exercising due diligence, could not prevent or overcome, and Article IX, *Impairment of Deliveries*, which allowed for a priority system of prorationing in the event of a gas shortage.<sup>13</sup>

In the gas sales contract, United did not guarantee that the gas supply would be from an intrastate source rather than from an interstate source. Texasgulf's Bully Camp mine was served with gas from United's facilities that were designated by United as New Orleans District Five. United began delivering gas to Texasgulf in May of 1968. At that time the FPC was exercising no jurisdiction over sales by United in its New Orleans District Five. In October of 1970, United applied for an FPC certificate for District Five as a part of its interstate system. District Five was certificated by the Commission in 1973; certification was later held applicable to customers such as Texasgulf as of 1965.<sup>14</sup>

United began curtailments thirty-one days after applying for the certificate.<sup>15</sup> From November 1970 through November 1971, Texasgulf limited its takes of gas to that amount which was allotted by United. From December of 1971 until November

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<sup>9</sup>*Id.* at 1333.

<sup>10</sup>*Id.*

<sup>11</sup>*Id.*

<sup>12</sup>*Id.* at 1332-33.

<sup>13</sup>*Id.* at 1333. Article IX did not include any "without liability" language.

<sup>14</sup>United Gas Pipe Line Co., 50 F.P.C. 181 (1973) (Opinion No. 661, Opinion and Order Issuing Certificate of Public Convenience and Necessity); United Gas Pipe Line Co., 50 F.P.C. 779 (1973) (Opinion No. 661-A, Opinion and Order Denying Rehearing). See United Gas Pipe Line Co., 54 F.P.C. 796, 799 (1975); *Texasgulf*, 610 F. Supp. at 1336. There was some speculation that United gained Commission certification in an attempt to shield itself from liability for curtailing service. See, e.g., United Gas Pipe Line Co., 20 F.E.R.C. at 65,292.

<sup>15</sup>Continuous curtailment of deliveries by United commenced on November 3, 1970. United Gas Pipe Line Co., 31 F.E.R.C. at 61,763.

of 1972, Texasgulf deliberately violated its allotments.<sup>16</sup> After the FPC and a federal court enforced compliance with United's curtailment plan,<sup>17</sup> Texasgulf shut down its mining operations temporarily. The mine was returned to service, supplied partially by gas from United, and forced to buy gas from other sources at higher prices.<sup>18</sup> The mine remained open until July of 1978, when Texasgulf abandoned the mine, leaving 1,398,804 tons of unmined sulphur in the ground.<sup>19</sup>

## II. THE PRIMARY JURISDICTION DISPUTE

### A. *The Basis for Commission Assertion of Primary Jurisdiction*

In legal disputes involving a regulated industry, it is often necessary to integrate the regulatory agency into the judicial decision-making process.<sup>20</sup> Stated briefly, the doctrine of primary jurisdiction governs the determination of whether a court should make an initial decision on an issue, or whether an administrative agency should first hear and decide the issue.<sup>21</sup> The primary jurisdiction doctrine "requires judicial abstention in cases where protection . . . of the integrity of a regulatory scheme dictates preliminary resort to the agency which administers the scheme."<sup>22</sup> Primary jurisdiction over certain issues was vested in the Commission in this case because Texasgulf's Bully Camp mine received gas from a certificated interstate system.<sup>23</sup> Before reaching the merits, the D.C. District Court had to determine what issues were within the primary jurisdiction of the Commission and whether it was proper to proceed in the absence of a Commission ruling on those issues.

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<sup>16</sup>Texasgulf "took from the pipeline the amount of gas it believed necessary to continue operating its mine." *Texasgulf*, 610 F.Supp. at 1334.

<sup>17</sup>In *Texas Gulf, Inc. v. FPC*, 494 F.2d 789 (5th Cir. 1974), the Fifth Circuit Court of Appeals approved an FPC order which ordered Texasgulf to obey United's curtailment plan (which allotted Texasgulf a minimum of 1,500 Mcf of gas per day, instead of the maximum 10,100 Mcf Texasgulf had contracted for) and to pay back its overtakes by reducing subsequent allocations to 1,500 Mcf per day. The court also affirmed the portion of the FPC order which required United to install a control device on its supply line to Texasgulf in order to prevent overtakes.

<sup>18</sup>*Texasgulf*, 610 F.Supp. at 1334.

<sup>19</sup>United Gas Pipe Line Co., 20 F.E.R.C. at 65,315-16.

<sup>20</sup>Mississippi Power and Light Co. v. United Gas Pipe Line, 532 F.2d 412, 417 (5th Cir. 1976). For a discussion of FERC's primary jurisdiction in gas contract litigation, see Pierce, *Issues In Gas Contract Litigation*, 35 INST. ON OIL & GAS L. & TAX'N 61, 67-71 (1984).

<sup>21</sup>4 KENNETH CULP DAVIS, ADMINISTRATIVE LAW TREATISE § 22:1 (2d ed. 1983). This concept was first announced in the case of *Texas & Pac. Ry. v. Abilene Cotton Oil Co.*, 204 U.S. 426 (1907), where the Supreme Court, presented with the issue of whether a state court had jurisdiction to entertain a case involving an alleged violation of the Interstate Commerce Act, stated: "[A] shipper seeking reparation predicated upon the unreasonableness of the established rate must, under the act to regulate commerce, primarily invoke redress through the Interstate Commerce Commission, which body alone is vested with power originally to entertain proceedings for the alteration of an established schedule . . ." *Id.* at 448.

For a more detailed discussion of the origin of the primary jurisdiction doctrine, see Jaffe, *Primary Jurisdiction*, 77 HARV. L. REV. 1037 (1964); Convisser, *Primary Jurisdiction: The Rule and Its Rationalizations*, 65 YALE L. J. 315 (1956).

<sup>22</sup>*United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 353 (1963). See also *Far East Conference v. United States*, 342 U.S. 570 (1951); *Great N. R.R. v. Merchants Elevator Co.*, 259 U.S. 2851 (1921); Schwartz, *Legal Restrictions of Competition in the Regulated Industries*, 67 HARV. L. REV. 436, 464 (1954).

<sup>23</sup>See *supra* note 14 and accompanying text.

### B. *The Extent and Effect of Commission Jurisdiction Over the Dispute*

Two major caveats accompany the doctrine of primary jurisdiction: (1) primary jurisdiction, even when applicable, does not always extend to every issue within a dispute;<sup>24</sup> (2) a determination that an agency has primary jurisdiction as to an issue does not necessarily mean that a court will not eventually decide the issue.<sup>25</sup> In the *Texasgulf* case, the Commission's primary jurisdiction extended only to those issues within the Commission's unique expertise.<sup>26</sup> In February of 1979, the district court referred three issues, which it felt were within the Commission's expertise, to the Commission for determination.<sup>27</sup> Although the Commission did not have primary jurisdiction to determine the extent of United's liability for breach of contract, the Commission had primary jurisdiction to determine whether damage awards against United for breach of contract would grant those parties receiving damage awards an undue preference or advantage in contravention of § 4(b) of the Natural Gas Act.<sup>28</sup> It was proper, therefore, for the court to defer to the Commission before trying the breach of contract claim.

The fact that the Commission had primary jurisdiction over the "undue preference" issue did not mean that a court could not rule on the issue also.<sup>29</sup> The Supreme Court has ruled that "[c]ourt jurisdiction is not thereby ousted, but only postponed."<sup>30</sup> The Supreme Court also has ruled that "[t]he holding that the [agency] had primary jurisdiction, in short, was a device to prepare the way, if the litigation should take its ultimate course, for a more informed and precise determination by the court of the scope and meaning of the statute as applied to those particular circumstances."<sup>31</sup> In the *Texasgulf* dispute, the Commission had a positive duty under the primary jurisdiction doctrine to determine the legal and

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<sup>24</sup>DAVIS, *supra* note 21, at § 22:1.

<sup>25</sup>*Id.*

<sup>26</sup>*See* *Nader v. Allegheny Airlines*, 426 U.S. 290, 303-07 (1976).

<sup>27</sup>The three issues were:

1. Does Section 12.1 or any other of United's tariff provisions or any general or specific orders of the Commission remove or limit United's potential contract liability to Texasgulf for curtailments?
2. Would the awarding of damages to Texasgulf for United's curtailments grant Texasgulf an undue preference or advantage in contravention of the Natural Gas Act?
3. What would be the effect of Section 12.3 of United's tariff upon United's potential contract liability to Texasgulf for curtailments?

*Texasgulf*, 610 F.Supp. at 1331, n. 3.

<sup>28</sup>15 U.S.C. § 717c(b)(1982). There is no firm rule as to which issues are to be considered within the primary jurisdiction of the affected administrative agency. DAVIS, *supra* note 21, at 81-82. Apparently the federal district court felt that these issues necessarily implicated the Natural Gas Act which reads in part: "No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission . . . make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage . . ." 15 U.S.C. § 717C(b) (1982).

<sup>29</sup>DAVIS, *supra* note 21, at 82.

<sup>30</sup>*Philadelphia Nat'l Bank*, 374 U.S. 321, 353 (citing *General Am. Tank Car Corp. v. El Dorado Terminal Co.*, 308 U.S. 422, 433 (1939); *Federal Maritime Bd. v. Isbrandtsen Co.*, 356 U.S. 481, 489-99 (1958); 3 DAVIS, ADMINISTRATIVE LAW 1-55 (1958)).

<sup>31</sup>*Isbrandtsen*, 356 U.S. at 498-99.

practical ramifications of its valid orders;<sup>32</sup> the ultimate issue of United's contract liability was within the sole province of the courts.<sup>33</sup>

### C. Propriety of the District Court Trial

It was proper for the district court to hear the *Texasgulf* case after making reasonable attempts to obtain Commission review of those issues within the primary jurisdiction of the Commission. According to the Supreme Court's ruling in the *Chicago Mercantile Exchange* cases,<sup>34</sup> a court need only make "reasonable efforts" to invoke the jurisdiction of the agency. In *Ricci v. Chicago Mercantile Exchange*,<sup>35</sup> the plaintiff filed an antitrust suit against the Chicago Mercantile Exchange, charging it with violation of the Commodity Exchange Act. The Supreme Court held that although the Commodity Exchange Commission could not decide whether the Commodity Exchange Act immunized conduct from antitrust laws, the court's proceedings should be stayed pending the determination of certain issues within the special competence of the Commodity Exchange Commission.<sup>36</sup> In the subsequent case of *Chicago Mercantile Exchange v. Deaktor*,<sup>37</sup> the Supreme Court interpreted the federal court's duty to be not to "go forward without making *reasonable efforts* to invoke the jurisdiction of the Commission."<sup>38</sup>

Although the Court's opinion did not define "reasonable efforts," common sense dictates that substantial deference<sup>39</sup> and over five year's of inaction on the Commission's part in the *Texasgulf* dispute<sup>40</sup> was sufficient to meet the "reasonable efforts" standard. This contention is particularly persuasive because the Commission's role in determining ultimate contract liability was only advisory in the *Texasgulf* dispute.<sup>41</sup> The federal district court expressed concern that to defer action would be to abdicate power to the Commission.<sup>42</sup> In view of the purposes behind the

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<sup>32</sup>See *Weymouth v. Colorado Interstate Gas Co.*, 367 F.2d 84, 102-03 (5th Cir. 1966); *J.M. Huber Corp. v. Denman*, 367 F.2d 104, 121 (5th Cir. 1966); *International Paper Co. v. FPC*, 476 F.2d 121, 130 (5th Cir. 1973) (concurring opinion of Brown, C.J.); *United Gas Pipe Line Co.*, 49 F.P.C. 1211, 1220 (1973).

<sup>33</sup>See *International Paper*, 476 F.2d 121, *passim*; *United Gas Pipe Line Co.*, 49 F.P.C. at 1221; *United Gas Pipe Line Co.*, 31 F.E.R.C. at 61,768.

<sup>35</sup>409 U.S. 289.

<sup>36</sup>*Id.* at 302.

<sup>37</sup>414 U.S. 113.

<sup>38</sup>*Id.* at 115 (emphasis added).

<sup>39</sup>The original complaint in this case was filed November 10, 1971. The court had deferred to the Commission four times since then. See *Texasgulf*, 610 F.Supp. at 1331-32.

<sup>40</sup>On February 12, 1979, the court stayed further proceedings for the fourth time and referred three specific issues to the FERC for determination under its primary jurisdiction. See *supra* note 27 and accompanying text. See also *Texasgulf*, 610 F.Supp. at 1331. On September 14, 1982, a decision on these issues was handed down by a FERC administrative law judge, but this was an initial decision only and was intended to bring basic issues in the administrative proceeding into focus for Commission decision. By orders of October 26, 1984, and December 7, 1984, the District court established a trial schedule. Trial began on February 25, 1985. *Id.* at 1332. It is interesting to note that 15 days after the *Texasgulf* opinion was issued by the D.C. Court, the final FERC ruling on the matter was reported. See *United Gas Pipe Line Co.*, 31 F.E.R.C. ¶ 61,336 (Opinion No. 237; Opinion and Order Affirming Initial Decision).

<sup>41</sup>See *supra* notes 29-33 and accompanying text.

<sup>42</sup>*Texasgulf*, 610 F.Supp. at 1332, n.5.

doctrine of primary jurisdiction and in view of the court's efforts to invoke Commission action on those issues within the Commission's primary jurisdiction, the *Texasgulf* court was proper in proceeding to trial.

### III. A COMMISSION-APPROVED TARIFF AS A DEFENSE TO A BREACH OF CONTRACT ACTION

#### A. *United's Tariff and Automatic Insulation from Liability*

The *Texasgulf* Court held that United's Commission-approved tariff did not, standing alone, automatically insulate United from liability for breach of contract. United's tariff was its authority for curtailment<sup>43</sup> and represented the "only extent to which United can claim its liability is subject to federal preemption . . ."<sup>44</sup> United's tariff controls the terms of its service.<sup>45</sup> The tariff was filed in 1952<sup>46</sup> and has been in effect since its approval in 1954.<sup>47</sup> Curtailment amendments were filed pursuant to FPC Order No. 431,<sup>48</sup> but those amendments did not receive final approval until after the *Texasgulf* decision was rendered.<sup>49</sup> Therefore, United's claim of insulation from liability was judged under the 1954 tariff.<sup>50</sup>

The court referred to a series of FPC and federal court opinions in which the "automatic insulation" principle was discussed. In Opinions 606<sup>51</sup> and 606-A,<sup>52</sup> the FPC ruled that an FPC-approved tariff could insulate an interstate pipeline from liability for breach of contract. The Fifth Circuit Court of Appeals, in *International Paper Co. v. FPC*,<sup>53</sup> rejected this notion owing to the FPC's failure to find that the contract terms to be abrogated were "not in the public interest" and to the absence of an FPC determination that adherence to the contract terms would grant the pipeline's customer an "undue preference" under section 4(b) of the Natural Gas Act.<sup>54</sup> In Opinions 647<sup>55</sup> and 647-A,<sup>56</sup> the FPC reaffirmed its holdings in Opinions 606 and 606-A that a tariff could automatically exculpate a pipeline from liability for breach of contract. In 647-A, the FPC asserted United faced no general contract

<sup>43</sup>See *supra* notes 3 and 4, and accompanying text.

<sup>44</sup>*Texasgulf*, 610 F.Supp. at 1336. This a result of the fact that "[T]here is no provision of the Natural Gas Act as such dealing with a pipeline's liability under its contracts with its customers." *Id.*

<sup>45</sup>See FERC Rate Schedules and tariffs, 18 C.F.R. § 154 (1985).

<sup>46</sup>United Gas Pipe Line Co., 11 F.P.C. 1162 (1952).

<sup>47</sup>See United Gas Pipe Line Co., 13 F.P.C. 398 (1954).

<sup>48</sup>For discussion of FPC Order Number 431, see *supra*, note 3. According to the *Texasgulf* Court, United was obligated to follow its voluntary tariff amendments upon filing, but at the time of trial the legality of the tariffs was "an open question." *Texasgulf*, 610 F.Supp. at 1336 (citing *Hercules, Inc. v. FPC*, 552 F.2d 74, 87 (3rd Cir. 1977)).

<sup>49</sup>See United Gas Pipe Line Co., 31 F.E.R.C. ¶ 61,336, where the Commission approved Section 12.1 of United's tariff (the section United claimed allowed it to prorate without liability) but only after amending so United could not prorate without liability if it was guilty of negligence, bad faith, fault or willful misconduct. *Id.* at 61,770.

<sup>50</sup>*Texasgulf*, 610 F. Supp. at 1336.

<sup>51</sup>*Id.* at 1336.

<sup>52</sup>United Gas Pipe Line Co., 46 F.P.C. 786 (1971).

<sup>53</sup>476 F.2d 121 (5th Cir. 1973).

<sup>54</sup>*Id.* at 127-28.

<sup>55</sup>United Gas Pipe Line Co., 49 F.P.C. 179 (1973).

<sup>56</sup>United Gas Pipe Line Co., 49 F.P.C. 1211 (1973).

liability because its management had not been engaged in "improvidence or willful misconduct."<sup>57</sup> The Fifth Circuit Court of Appeals responded in *State of Louisiana v. FPC*<sup>58</sup> by Stating that the FPC had overstepped its bounds in ruling that United was exculpated automatically: "[b]y assuming United's immunity FPC assumes too much."<sup>59</sup>

The *Texasgulf* court had several bases for holding that the existence of the tariff does not automatically preempt a breach of contract cause of action.<sup>60</sup> The court reasoned that while the tariff "does apply as a matter of federal law and . . . supplants exculpatory standards of state law"<sup>61</sup> federal control of contract terms by incorporating them in a tariff does not preempt *all* state law.<sup>62</sup> The court reasoned further that although the FPC had exclusive jurisdiction over certain provisions of the United/Texasgulf gas sales agreement, the Commission did not have exclusive jurisdiction over the entire agreement.<sup>63</sup> In reaching its holding, the *Texasgulf* court relied partially on the *Mobile-Sierra* doctrine,<sup>64</sup> which prohibits agencies from permitting regulatees to abrogate private contracts unilaterally by filing tariffs.<sup>65</sup> The court, referring to *Nader v. Allegheny Airlines*,<sup>66</sup> stated further that "[n]othing in the Natural Gas Act expressly authorizes the Commission to immunize companies like United from common-law damage actions . . ."<sup>67</sup> and that to preempt *Texasgulf's* breach of contract claim would be inconsistent with the

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<sup>57</sup>*Id.* at 1221. The FPC indicated that a tariff could not exculpate a pipeline company automatically from a breach of contract claim if the pipeline was "guilty of bad faith, or was improvident or negligent" and that under those circumstances damages for breach of contract could be imposed by a U.S. District Court. *Id.* The FPC then held that United was not guilty of bad faith, improvidence, or negligence, but recognized that this issue was for the courts to determine:

[W]e have neither the power nor desire to adjudicate United's contract liability, for as recognized in *International Paper*, that is within the province of the appropriate court. However, on the basis of the record in this proceeding, we must reaffirm our conclusion in Opinion No. 647 . . . that United has not been guilty of any improvidence or willful misconduct in its actions.

*Id.*

<sup>58</sup>503 F.2d 844 (5th Cir. 1974).

<sup>59</sup>*Id.* at 868. The court felt that the FPC's ruling in Opinion Number 647-A amounted to a "premature determination of United's contract liability . . ." *Id.* at 867. The court then vacated and remanded the FPC opinion.

<sup>60</sup>*Texasgulf*, 610 F.Supp. at 1334-40.

<sup>61</sup>*Id.* at 1339 (citing *FPC v. Louisiana Power and Light Co.*, 406 U.S. 621, 646 (1972)).

<sup>62</sup>*Texasgulf*, 610 F.Supp. at 1339. The court reasoned that to hold otherwise would "depriv[e] United's customers of the right to sue for damages when gas is not delivered as contracted." *Id.* (citing *Pennzoil Co. v. FERC*, 645 F.2d 360, 385 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982)).

<sup>63</sup>*Texasgulf*, 610 F.Supp. at 1340.

<sup>64</sup>The *Sierra-Mobile* doctrine evolved from the Supreme Court cases of *FPC v. Sierra Pac. Power Co.*, 350 U.S. 348 (1956), and *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956).

<sup>65</sup>See, e.g., *R.C.A. Global Communications, Inc. v. FCC*, 717 F.2d 1429, 1432 (D.C. Cir. 1983); *M.C.I. Telecommunications Corp. v. FCC*, 665 F.2d 1330, 1302 (D.C. Cir. 1981); *Bell Tel. Co. of Pa. v. FCC*, 503 F.2d 1250, 1280 (3rd Cir. 1974).

<sup>66</sup>426 U.S. 290 (1976).

<sup>67</sup>*Texasgulf*, 610 F.Supp. at 1340 (citing *Nader*, 426 U.S. at 301).



purpose of the Natural Gas Act.<sup>68</sup> While the tariff does not automatically exculpate United from liability, the court acknowledged that United's 1954 tariff must be examined for valid exculpatory clauses.<sup>69</sup>

*B. The "Force Majeure" and "Impairment of Deliveries" Provisions of United's Tariff and Insulation from Liability*

The force majeure and impairment of deliveries provisions of United's tariff did not automatically insulate United from liability, the court held. The force majeure and impairment of deliveries provisions in United's tariff contained the only tariff language that could be construed to exculpate United from liability.<sup>70</sup> Under Section 11 of the tariff, a *force majeure* was defined as any cause for failure to deliver gas to a customer, which was outside United's control, *i.e.*, which, by the exercise of "*due diligence*" United was "unable to prevent or overcome."<sup>71</sup> Section 12.1 provided that "[i]n the event a shortage of gas renders [United] unable to supply the full gas requirements of all of its consumers, then [United] may, *without liability* to Buyer prorate its gas supply in the manner herinafter set forth . . . ."<sup>72</sup> In *Texasgulf*, United argued that "due diligence" meant a lack of recklessness or intentional wrongdoing.<sup>73</sup> United also contended that the due diligence standard of Section 11 applied only when the pipeline invoked the provisions of the *force majeure* clause.<sup>74</sup> United's contentions troubled the *Texasgulf* court, because the adoption of that view essentially would grant United a license to prorate without liability any time it faced a gas shortage, regardless of its role in causing the shortage.<sup>75</sup>

The District of Columbia District Court held that sections 11 and 12.1 must be read in conjunction with each other,<sup>76</sup> and that before being exonerated from

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<sup>68</sup>The *Texasgulf* court stated that "total preemption of Texasgulf's breach of contract cause of action is inconsistent with the purpose of the Natural Gas Act 'to protect consumers against exploitation at the hand of natural gas companies . . . and to assure continuity of supply.'" *Texasgulf*, 610 F.Supp. at 1340 (citing *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944)).

The district court also referred to recent Commission cases rejecting the same broad exculpation United urged in the case, and stated, "as a general rule blanket exculpatory clauses in contracts are disfavored. . . . Such clauses in tariffs receive favor only where the regulatory body in the exercise of its primary jurisdiction expressly approves the exculpation for stated reasons consistent with its regulatory scheme." *Texasgulf*, 610 F.Supp. at 1339 (citations omitted).

<sup>69</sup>*Id.* at 1336.

<sup>70</sup>These provisions are set out in full in the appendix to the case, *id.* at 1357-59.

<sup>71</sup>*Id.* at 1357-58 (emphasis added). It is interesting to note that in this case United did not invoke a *force majeure* defense. *See id.* at 1337, n. 32.

<sup>72</sup>*Id.* at 1358 (emphasis added).

<sup>73</sup>*Id.* at 1337.

<sup>74</sup>*Id.*

<sup>75</sup>*Id.* at 1337-38.

<sup>76</sup>*Id.* at 1338. The court did not believe that the Commission meant to approve a tariff

that first under section 11 placed a due diligence standard on United to meet its contractual obligations in the face of extraordinary *force majeure* events such as war, riots, storms, epidemics and earthquakes, and second under section 12.1 allowed United to escape liability for shortages entirely by prorating even where proration resulted from a shortage that was caused by its own lack of due diligence.

*Id.* at 1337-38. The *Texasgulf* court was correct. Subsequent to the time of the *Texasgulf* trial, FERC amended Section 12.1 so that United could prorate only in the absence of its negligence, bad faith, fault or willful misconduct. *See supra*, note 49.

liability for prorating gas supplies, United must show that it exercised due diligence in avoiding the shortage that led to the proration.<sup>77</sup> The court reasoned that to allow a pipeline automatically to prorate supplies without liability regardless of its role in creating the shortage would be inconsistent with "the federal interest in continuity of supply and orderly curtailments pursuant to Commission orders."<sup>78</sup> The court reasoned also that its holding on this issue was in accord with accepted principles of statutory construction<sup>79</sup> and with recent Commission rulings rejecting blanket exculpatory clauses in tariffs.<sup>80</sup> After establishing that United could be protected by its tariff only if it had exercised due diligence in avoiding the shortage, the *Texasgulf* court turned to the facts of the case to determine whether United had met the due diligence standard.

#### IV. UNITED'S FAILURE TO EXERCISE DUE CARE

##### A. *Nature of the Duty*

The Federal District Court in *Texasgulf* concluded that "in a number of significant respects, United failed to manage its system with due care and . . . these failings proximately caused the shortage that eventually led to United's curtailment and caused United to breach the Gas Sales Agreement."<sup>81</sup> Since liability turned on United's failure to exercise due care, it is important to define the "due care" standard and to determine how United failed to meet that standard.

United, as an interstate pipeline, is subject to the Natural Gas Act.<sup>82</sup> The fundamental purpose of the Natural Gas Act is to assure an adequate and reliable supply of gas at reasonable prices.<sup>83</sup> The court applied these precepts by saying United was "obligated by its own tariff and by the Natural Gas Act to exercise due care in providing continuity of service."<sup>84</sup> "Due care" in this context meant a lack of negligence or willful misconduct.<sup>85</sup> In its *Memorandum on Liability*, the court placed upon United the burden of proof to establish that it did not willfully or negligently cause the shortage that preceded its breach of the Texasgulf Bully Camp dome contract.<sup>86</sup> In determining whether United was liable for breach of contract, the court analyzed the sequence of events leading to the curtailment and determined

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<sup>77</sup>*Id.* at 1338. The basis for the due diligence standard was section 11 of United's 1954 tariff. *Id.* The court defined due diligence as a simple negligence standard of due care. It stated that the negligence standard is a balance between automatic exculpation and strict liability, and is in accord with the fundamental purpose of the Natural Gas Act. *Id.* at 1339.

<sup>78</sup>*Id.* at 1338 (footnote omitted).

<sup>79</sup>*Id.* at 1338, n. 33.

<sup>80</sup>*Id.* at 1339; see also *supra* note 68 and accompanying text.

<sup>81</sup>*Id.* at 1343.

<sup>82</sup>See *Texasgulf*, 610 F. Supp. at 1332, 1340.

<sup>83</sup>*California v. Southland Royalty Co.*, 436 U.S. 519, 523 (1978); *Sunray MidContinent Oil Co. v. FPC*, 364 U.S. 137, 147, 151-54 (1960); *Atlantic Ref. Co. v. Public Serv. Comm'n of N.Y.*, 360 U.S. 378, 388 (1959).

<sup>84</sup>*Texasgulf*, 610 F. Supp. at 1340.

<sup>85</sup>*Id.* at 1339. For further discussion of the standard of care owed by United, see *supra*, note 77.

<sup>86</sup>*Texasgulf*, 610 F. Supp. at 1339.

whether United exercised due care in light of its duty to provide continuous and adequate service to its customers.<sup>87</sup>

## B. Breach of Duty To Provide Continuous Service

### 1. United's Failure To Exercise Due Care In Entering Into The Agreement With Texasgulf

After it executed the gas sales agreement, United experienced swift and substantial curtailment.<sup>88</sup> The district court found that United was the nation's leading gas service curtailer,<sup>89</sup> but did not base liability solely on this factor. Instead, the court looked to the conditions surrounding the curtailment and examined United's role in exacerbating those conditions.

The court found that United did not have sufficient reserves to back its commitment to Texasgulf at the time the gas sales agreement was executed.<sup>90</sup> The

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<sup>87</sup>The tariff was not the only source of United's duty to exercise due care. Every contract contains an implied covenant of "good faith" and "fair dealing" which prohibits any contracting party from injuring another contracting party's right to receive the benefits of the agreement. See RESTATEMENT (SECOND OF CONTRACTS) § 205 (1981) and comments following. Both the common law and the Uniform Commercial Code also impose the implied covenant of good faith and fair dealing. See Burton, *Breach of Contract and the Common Law Duty to Perform In Good Faith*, 94 HARV. L. REV. 369 (1980); Burton, *Good Faith Performance of a Contract Within Article 2 of the Uniform Commercial Code*, 67 IOWA L. REV. 1 (1981); Farnsworth, *Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 666 (1963).

Throughout its discussion of liability, the court spoke in terms of United's negligence preceding its breach of contract. For example, in its conclusion the court states that United's lack of due care (i.e., negligence and/or willful misconduct) caused it to breach its contract with Texasgulf. *Texasgulf*, 610 F. Supp. at 1357. Although the court never addresses directly the issue of whether United could be held liable for "tortious breach of contract," it is possible that this issue could arise at the damages portion of the trial. It would be noteworthy if the federal district court were to extend actual "contort" principles to the *Texasgulf* case, since courts are willing generally only to extend these principles to common carriers, insurance companies and other regulated industries possessing certain monopolistic qualities. For a discussion of the theories behind "Tortious breach of contract", see Simpson, *Punitive Damages for Breach of Contract*, 20 OHIO ST. L.J. 284 (1959); Note, "Contort": *Tortious Breach of the Implied Covenant of Good Faith and Fair Dealing in Noninsurance Commercial Contracts — Its Existence and Desirability*, 60 NOTRE DAME L. REV. 510 (1985); Note, *The Expanding Availability of Punitive Damages in Contract Actions*, 8 IND. L. REV. 668 (1975).

<sup>88</sup>One month after applying for interstate certification of its District Five with the FPC (see *supra*, note 14), United petitioned the FPC pursuant to § 4(b) of the Natural Gas Act, codified at 15 U.S.C. § 717(c) (1982), for a declaratory order holding that its curtailment plan to be initiated on November 1, 1970 complied with its existing contracts and recorded tariffs. See *Texas Gulf, Inc. v. FPC*, 494 F.2d 789, 790 (5th Cir. 1974). United's curtailment program was subsequently approved by the FPC and by the federal courts. See *id.* at 790-92. In *Texas Gulf*, the Court of Appeals for the Fifth Circuit approved a revised tariff whereby Texasgulf was guaranteed delivery of a minimum of 1,500 Mcf of gas per day to its Bully Camp mine. *Id.* at 791. This was far below the 10,100 Mcf per day level the parties had contracted for originally.

<sup>89</sup>United curtailed more service in the 1970s than any other pipeline, both in terms of gross volume and volume as a percent of sales. For example, . . . [i]n 1976-77, United curtailed 48.34 percent of its sales . . . . The next highest figure [was] 43.17 percent. . . . United's curtailments also began earlier than other pipelines, and the curtailments were by no means universal. . . . In 1976-77, United was one of 31 curtailing where 19 did not curtail.

*Texasgulf*, 610 F. Supp. at 1357 (footnotes omitted).

<sup>90</sup>*Id.* at 1343.

*Texasgulf* court reasoned that although the full extent of United's shortage in the 1970s could not have been foreseen in 1967, United should have foreseen the strong probability of an impending shortage on its system. "By executing a firm delivery contract . . . without ever advising *Texasgulf* that it might need an alternative fuel source, United violated its duty of due care."<sup>91</sup> The court's concern was not focused solely on the finding that United knew that it was facing a shortage and nevertheless entered into a new contract. The court found United blameworthy for dealing with a direct user who required a continuous and reliable source of natural gas without warning the then-potential customer that it might need an alternative fuel source.<sup>92</sup> Imposition of a duty to warn seems reasonable in view of the tremendous investment *Texasgulf* had in its Bully Camp dome and in view of the fact that United knew certainly that it was facing a supply shortage — a shortage magnified by United's own actions.

Throughout the proceeding United portrayed itself "as merely another victim of the natural gas shortage that enveloped the United States in the 1970s."<sup>93</sup> The court rejected this portrayal of United as a mere victim, finding that United played a large role in causing its own shortage of supply. In the early 1960s, United, faced with oversupply conditions and onerous take-or-pay penalties, opted to release committed reserves in exchange for relief from a portion of its potential take-or-pay liabilities.<sup>94</sup> By 1968, United had lost sixty-seven percent of its deliverability in its New Orleans District Five because of these contract modifications.<sup>95</sup> United also stopped acquiring new reserves from 1960 until 1966.<sup>96</sup> By the time United attempted to acquire new reserves in 1967, uncommitted gas was "getting kind of hard to find."<sup>97</sup> In fact, United had encountered a gas shortage which would affect its deliverability for several years.

Before signing the gas sales agreement with *Texasgulf*, United had actual notice of its deteriorating reserve situation and of an imminent shortage.<sup>98</sup> This deteriorating reserve situation was reflected in routine in-house studies performed for United<sup>99</sup> and in United's Form 15 Annual Reports.<sup>100</sup> General industry conditions also put United on notice that new reserves would be difficult to

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<sup>91</sup>*Id.*

<sup>92</sup>*See id.*

<sup>93</sup>*Id.* at 1357.

<sup>94</sup>*Id.* at 1344.

<sup>95</sup>*Id.* at 1345. For a complete analysis of United's reserves, see *United Gas Pipe Line Co.*, 20 F.E.R.C. at 65,294-97.

<sup>96</sup>*Texasgulf*, 610 F. Supp. at 1344. The *Texasgulf* court indicated that other interstate pipelines were increasing their reserves at this time. *Id.* at 1345.

<sup>97</sup>*Id.* at 1345, n. 48.

<sup>98</sup>*Id.* at 1345-47. *See also* *United Gas Pipe Line Co.*, 20 F.E.R.C. at 65,297-99.

<sup>99</sup>For example, a January, 1967 report by United's parent corporation "advised [United] that 'present reserves will be able to meet annual sales requirements through 1968 when local shortages will begin to appear' . . . . [T]he most probable condition and the one on which United should predicate its long-range planning is that of a basic shortage.'" *Texasgulf*, 610 F. Supp. at 1346 (footnote omitted).

<sup>100</sup>As natural gas pipeline subject to the jurisdiction of the FPC, United was required to provide Form 15 Reports to the FPC. These reports contain extensive information regarding the pipeline's overall supply situation. In the annual report, the pipeline is required to set forth its estimated gas supply as of the end of the year and its estimated dedicated reserves added during the report year. The pipeline is also required to submit a general statement regarding the company's gas procurement activity and the status of its exploration and development activity. *United Gas Pipe Line Co.*, 20

secure.<sup>101</sup> As evidence of United's knowledge that a shortage on its system was imminent, the court pointed to the fact that United intentionally misreported its reserves to the FPC.<sup>102</sup> As further evidence of United's knowledge, the court cited the misleading nature of its contract with Texasgulf.<sup>103</sup>

The court acknowledged that the fact that at the time the gas sales agreement was executed United did not have adequate reserves to fulfill the terms of the contract was not a sufficient basis upon which to predicate liability. In fact, it is a common industry practice to enter gas sales contracts without having sufficient reserves to back up the contract at the time the contract is signed. "Long-term gas supply contracts are typically executed by gas pipelines knowing they are required to add new reserves to fulfill delivery obligations in later years of the contract."<sup>104</sup> Hence, the court was required to look to United's subsequent actions as a further basis of liability.

## 2. *United's Failure To Exercise Due Care After Entering The Gas Sales Agreement*

Since United opted not to warn Texasgulf of the possibility of a shortage, United had an alternative duty to make certain that a shortage did not materialize. According to the court,

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F.E.R.C. at 65,298. The Form 15 Reports listed United's deliverability life index (the number of years into the future a pipeline can meet its current gas requirements using gas supplies already on hand), which until 1964 the FPC required to be at least 12 years but now may fluctuate according to a pipeline's success in obtaining reserves in a given year. In 1967, United's deliverability life index was six years; by 1970 the index had fallen to zero years. Although United blamed this decrease in its index partially to a new, more efficient method of determining the index number, the *Texasgulf* court discounted this notion and considered the index further evidence that United knew it was facing a shortage. *Texasgulf*, 610 F.Supp. at 1346.

<sup>101</sup>In 1969 the FPC formally recognized that a natural gas supply shortage was imminent. A Commission staff report "stated that '[E]vidence is mounting that the supply of natural gas is diminishing to critical levels in relation to demand,' and that 'on the basis of current trends only a few years remain before demand will outrun supply.'" United Gas Pipe Line Co., 20 F.E.R.C. at 65,291.

<sup>102</sup>The FPC relied on the annual Form 15 Reports to determine whether a pipeline had enough reserves to obtain FPC certification of new or enlarged service. *Texasgulf*, 610 F.Supp. at 1347-48. The *Texasgulf* court felt United wilfully misrepresented its position in the reports in order to gain undeserved certification of new and expanded service. See *id.* at 1347-50. For examples of United's misrepresentations in its Form 15 Reports, see *id.*; see also United Gas Pipe Line Co., 20 F.E.R.C. at 65,299-300, where an administrative law judge concluded that "[f]orm 15 Reports filed by United were not in total compliance with Commission regulation."

<sup>103</sup>United had a tariff on file with the FPC for the interstate portion of its system. The tariff contained language which United hoped would relieve it from liability in case it curtailed service. United had known since 1965 that its District Five service would eventually have to be certificated (since it was transporting interstate gas), but waited to apply for certification until the eve of curtailments — one month after United entered a contract with Texasgulf which did not contain "without liability" language in its *Impairment of Deliveries* clause. The *Texasgulf* court felt that this was evidence of United's knowledge of an impending shortage:

United's failure either to include the 'without liability' language in the Gas Sales Agreement or alternatively to alert Texasgulf specifically to the applicability of the tariff by reference to the need to certificate the service shows that United consciously hid from Texasgulf the escape hatch that it hoped would relieve it from liability if the expected shortage developed.

*Texasgulf*, 610 F.Supp. at 1350. See also *supra* note 14 and accompanying text.

<sup>104</sup>*Texasgulf*, 610 F. Supp. at 1343.

The significance of United's knowledge in 1967 that it might not be able to fulfill its obligations to Texasgulf is two-fold. First, the duty of due care is measured in proportion to the risk reasonably known at the time the duty is undertaken. A supplier of gas like United, undertaking an obligation to provide gas where it knows the harm from shortage will be severe and where it also knows the likelihood of shortage is strong, is under a particularly high duty to prevent the foreseeable harm. Second, a supplier who knows before entering a contract that there is a significant danger of supervening events rendering performance impossible can be held to have assumed the risk of those events materializing, and the contractor's subsequent excuses will be judged more strictly by the courts.<sup>105</sup>

If United had acted immediately, it might have cured its earlier negligence in entering the contract.<sup>106</sup> Instead, the court noted, United "compounded its earlier negligence by adding new business, failing to acquire reserves, and unrealistically pinning all its hopes on a single offshore project."<sup>107</sup> United's simultaneous expansion of service and failure to add new reserves in the face of a shortage can be attributed largely to a total lack of coordination between supply management and sales management within the company.<sup>108</sup> United's gas sales representatives apparently had no idea that a system shortage was imminent,<sup>109</sup> and continued to make new commitments.<sup>110</sup> While United's sales growth rate in the late 1960s was roughly comparable to that of other major pipelines, United, *unlike* other major pipelines, was unable to add reserves to keep up with its growing sales.<sup>111</sup> United was apparently lulled into a state of inaction by its high hopes for an offshore project which it knew or should have known would not come on line for several years.<sup>112</sup> United also might have been able to avoid curtailing Texasgulf had United been willing to buy gas at intrastate prices and resell it to Texasgulf at the interstate

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<sup>105</sup>*Id.* at 1350 (citations omitted).

<sup>106</sup>*Id.*

<sup>107</sup>*Id.* at 1350-51.

<sup>108</sup>During the years 1963 through 1970, no meetings were held between United's gas supply department and gas sales department to discuss problems of supply and sales. United Gas Pipe Line Co., 20 F.E.R.C. at 65,295.

<sup>109</sup>The United gas sales representative who negotiated the gas sales agreement with Texasgulf was totally unaware of United's supply situation. He represented to Texasgulf that United could meet Texasgulf's gas needs for the next 20 years. "He first learned of the shortage in January 1970 from an early morning telephone call rousting him from his bed to report for emergency curtailment work." *Texasgulf*, 610 F.Supp. at 1351.

<sup>110</sup>United contended that its new and expanded business resulted from commitments it had made in the mid 1960s. The district court rejected this contention as misleading, since in a number of cases United had only entered into informal agreements in the mid-1960s and did not execute formal gas sales agreements with parties to those informal agreements until several years later. In effect, the court reasoned, United chose to "honor . . . informal commitments when it should have known it would be unable to satisfy prior commitments such as the Texasgulf contract. . . ." *Id.* at 1352. "United thus violated its duty to satisfy its existing sales commitments before taking on new ones." *Id.*; accord *Louisiana v. FPC*, 533 F.2d 1239, 1243 (D.C. Cir. 1976); *Granite City Steel Co. v. FPC*, 320 F.2d 711, 713 (1963) (stating that "persons desiring gas for the first time, or desiring more gas, should not get it by taking it away from existing lawful customers.").

<sup>111</sup>See *Texasgulf*, 610 F.Supp. at 1354. United was one of only three major pipelines to show a decline in overall end-of-year reserves in the period between 1966 and 1970. In a study which compared United's annual withdrawals and end-of-year reserves from 1963 to 1969 with those of 10 other interstate pipelines buying gas in United's supply area, it was shown that the other pipelines increased sales 41% over the period, while United increased sales 26%; while the other pipelines showed a 14% increase in end-of-year reserves, United experienced a 35% decrease. *Id.*

<sup>112</sup>In 1969, the FPC authorized construction of an offshore gathering system named Sea Robin, an 80 million dollar joint venture between United and Southern Natural Gas Company. United relied

rate; United was not prepared to do this.<sup>113</sup> Because of the lack of coordination between supply management and sales management and because of United's management's knowing refusal to add reserves in the face of an imminent shortage, a gas shortage materialized on United's system and it curtailed service. These factors led to the court's ultimate holding that "United breached the contract by failing to deliver gas due to a shortage on its system that was proximately caused by United's lack of due care."<sup>114</sup>

### CONCLUSION

The *Texasgulf* case represents another step towards resolving the question of contractual liability of pipelines for damages caused by gas supply curtailments. The district court was justified in proceeding to trial after making reasonable efforts to invoke FERC jurisdiction over those issues within the Commission's realm of special expertise. The court summarized its holding concisely when it stated:

United's failure to deliver natural gas to Texasgulf in the amounts required by the terms of the Gas Sales Agreement was not caused by factors beyond United's control. United failed to supply natural gas to Texasgulf because its management did not use due care to preserve continuity of supply by maintaining a reasonable balance in the system between its available reserves and its delivery obligations. This violated United's duty as an interstate pipeline subject to the Natural Gas Act and caused it to breach its contract with Texasgulf. No provision of the Natural Gas Act, the Gas Sales Agreement, or United's tariff exonerates United for this negligent conduct, and United must respond to Texasgulf in damages, as later to be fixed by the Court in further proceedings.<sup>115</sup>

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extensively on the Sea Robin project as a panacea for its gas supply problems. For example, the United gas sales representative who negotiated the sales contract with Texasgulf represented to Texasgulf that "United already had all the gas needed to meet Texasgulf's need for 10 years ahead and that if the contract went to 20 years, gas from the Sea Robin offshore project would be available." *Id.* at 1351. Evidence in the case indicated that United knew that there would be a time lag between the exploration of the Gulf of Mexico offshore area and the time when the offshore reserves would become available to the company. Its expert witness testified at trial that, generally speaking, the time lag is at least seven years. *Id.* The fact that federal offshore lease sales did not begin in the area until December of 1970 indicates the unreasonableness of United's reliance on Sea Robin as a cure for its immediate gas supply problems. Again, the court felt that United had breached its duty of due care. "Sea Robin . . . had no prospect of preventing shortage and curtailment near-term, and United failed to exercise due care in relying upon it to meet needs in any substantial degree before the mid-1970s." *Id.* at 1355-56.

<sup>113</sup>United would not have profited from this type of arrangement, most likely. The *Texasgulf* court felt this was short-sighted of United. *Id.* at 1355. At the time, United was evidently willing to gamble on the notion that the existence of its tariff would insulate it from liability if it were forced to curtail, and that therefore it was unnecessary to put itself in a position of losing money on existing gas contracts.

<sup>114</sup>*Id.* at 1356.

<sup>115</sup>*Id.* at 1357.

The issues arising out of this breach of contract dispute are not yet settled conclusively. In addition to the possibility of appeals in the federal courts, the Commission has stated several times that if damages are awarded a curtailed gas customer, it would have an affirmative duty to assess the impact of the damage award on the pipeline's ability to continue service to its existing customers.<sup>116</sup> It is entirely possible, therefore, that there will be further interaction between the courts and the Commission before United, or any pipeline, is forced to respond in damages for negligently curtailing supply.

ANTHONY COLE DUENNER

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<sup>116</sup>*See e.g.* United Gas Pipe Line, 49 F.P.C. 1211, 1222-23 (1973) where the Commission Opinion stated:

[I]f a District Court finds that United, or any other similarly situated pipeline, is liable for damages, either for improvidence, negligence, or bad faith, or under substitute fuel clauses, this Commission has both a duty and a responsibility to assess the impact of such damages upon United's ability to continue to provide adequate and safe service to consumers. We do not consider it desirable public policy for this regulatory agency to intrude upon the province of the U.S. District Court. However, recognition must be given to the potential pitfalls from multiple forum adjudication by state and federal courts of the "providence" issue with respect to any given pipeline. Nor is it necessary at this juncture to determine from what sources damages would be paid, *i.e.*, shareholders, ratepayers, or some apportionment among both. The impact of a judgment execution against the unencumbered facilities of a pipeline utility and the consequent effect upon its financial integrity and ability to provide service to its customers can be determined in an appropriate regulatory proceeding. It should be recognized that shareholders' equity in pipelines is primarily plant-in-service and to the extent a judgment-plaintiff could levy against utility plant, this Commission must determine if the overall public interest would thereby be adversely affected.

*See also* United Gas Pipe Line Co., 31 F.E.R.C. at 61,773-74 (stating that "We . . . will not decide the [impairment of deliverability] issue at the present time since we would have to anticipate requests that may not be presented and events that may not come to pass.").