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Federal Circuit Finds Department of Interior Breached Contract With Pipeline

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On Friday, the U.S. Court of Appeals for the Federal Circuit issued an Order finding that the U.S. Department of Interior (DOI) materially breached its agreements with Rockies Express Pipeline (REX).[1] The Court also removed a limitation on damages previously imposed and remanded the case for recalculation of damages owed to REX.

Prior to the construction of the REX pipeline system, the DOI agreed to pay REX a reservation charge for at least 10 years per section of pipeline, reserving 2.5 percent of the gas shipped on the pipeline. The DOI would receive the gas as a royalty-in-kind for gas extracted from federal land. The DOI agreed to pay the reservation charge regardless of whether or not it shipped gas on the pipeline and REX agreed to maintain capacity for the DOI. The DOI also agreed to initial reservation charges for the REX West segment of $1,207,540 per month. The DOI agreed to pay reservation charges of $1,663,800 per month upon completion of the REX East segment of the pipeline.

REX and the DOI entered into a Precedent Agreement. During negotiations, the DOI requested a termination for convenience clause or a clause that would allow it to terminate the agreement if the DOI later abandoned its royalty-in-kind program. REX refused to agree to either clause. The parties ultimately agreed that the DOI could terminate only if it was "directed by Legislative Action or required by a change in the Federal or State policy to discontinue taking gas in kind . . . upon (30) thirty days written notice to [REX]." REX was given the right to terminate by giving the DOI five days' advance notice in the event the DOI failed to comply with any material obligations under the Precedent Agreement or a Firm Transportation Service Agreement then in effect.

FERC reviewed the Precedent Agreements, determined that building the pipeline was in the public interest, and treated all Precedent Agreements as binding. Thereafter, REX and the DOI entered into a Firm Transportation Service Agreement for the REX West segment and the DOI shipped gas on the pipeline under that agreement. However, the DOI later refused to sign the Firm Transportation Service Agreement for the REX East segment. REX terminated the Precedent Agreement for the REX East segment, claiming that the DOI was in material breach. The DOI refused to pay reservation charges on REX West and also stopped shipping gas on the pipeline even though its Precedent Agreements obligated it to continue to ship gas until the REX East segment was placed in service.

During the pendency of the dispute, the DOI announced its intention to phase out royalty-in-kind contracts. Termination of the royalty-in-kind program was to proceed according to a list of "guiding principles" including honoring all existing royalty-in-kind sales contracts.

Upon complaint by REX, the DOI's contracting officer concluded that the DOI was not in breach of its agreements. REX appealed the decision and the Civilian Board of Contract Appeals (Board) held that the Precedent Agreement was a contract for procurement of services and the DOI breached the contract by refusing to pay reservation charges on REX West and refusing to execute the REX East Firm Transportation Service Agreement. The Board concluded that the DOI was only liable for the reservation charges through the time that the DOI announced its intent to terminate the royalty-in-kind program and not the full 10 years of reservation charges that REX claimed based on the 10-year term of the Firm Transportation Service Agreements.

On appeal, the Court rejected the DOI's defenses that it did not have authority to enter into the contracts with REX and held that the DOI materially breached the Precedent Agreement upon its refusal to enter into the REX East Firm Transportation Service Agreement. The Court, citing the "guiding principle" that all existing royalty-in-kind contracts be honored, concluded that the DOI was obligated to honor the REX East Firm Transportation Service Agreement for the full 10-year duration and there was no change in federal policy that would have affected that agreement. The Court remanded the case to the Board to recalculate damages in accordance with the Order. The Court's removal of the damages limitation (originally imposed by the Board) could mean that the DOI will be liable to Rockies Express for up to the full $173 million claimed.

Endnotes

1 *Rockies Express Pipeline LLC v. Salazar, Case No. 2012-1055 (Fed. Cir. Sept. 13, 2013).*

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