



SHELL V. U.S.: COURT HOLDS GOVERNMENT TO ITS WORLD WAR II-ERA “GRAND BARGAIN” WITH AVIATION GAS REFINERS

by Christopher H. Marraro

An April 2014 U.S. Court of Appeals for the Federal Circuit decision bound the federal government to a 70-year old contractual promise it made to United States businesses. Under the contract, refining companies invested massive capital resources to increase the production of 100-octane aviation fuel during World War II. In return, the government assumed all costs, including contingent future regulatory costs. After regulators brought a Superfund lawsuit against the fuel refiners in 2006 to clean up the old refinery sites, the companies sued to recover those costs under the original contract. The Federal Circuit’s ruling sends a critical message to both regulators and the private entities that contract with them: The courts will enforce the government’s contractual promises regardless of changes in circumstances or how long ago the bargain was struck.

Background

World War II brought about marked unparalleled cooperation between government and private industry in America. Victory at all costs required government and industry to cooperatively overcome huge supply deficits and complex logistical barriers to provide unprecedented levels of “critical” materials to the Allied Forces. Commodities like aviation gasoline, copper, and steel were in short supply, and too few production facilities were available for the war effort. Some materials like rubber were mostly unavailable due to the fall of Singapore in 1939, where nearly all of the domestic supply of natural rubber was sourced.

During this period, the 100-octane aviation gasoline (avgas) program stood as the archetype of this unique government/private industry partnership. “Super-fuels” for air combat became a military focus after researchers discovered the formula for 100-octane aviation gasoline in the 1930s. So important was avgas to air combat that Great Britain’s Petroleum Secretary, Geoffrey Lloyd, remarked in 1943 that “we wouldn’t have won the Battle of Britain without 100-octane...”¹ Yet only slightly more than 40,000 barrels per day were being refined domestically in 1941 and a staggering increase in production was required to satisfy the Armed Forces’ need for at least 190,000 barrels per day.

But avgas refining capacity was already overbuilt and oil refining economics would not justify the roughly \$900 million dollars (\$14 billion in 2014 dollars) of capital investment needed to increase production to meet the Armed Forces’ need. The solution came in the form of a “grand bargain” between government and the petroleum refining industry whereby the government agreed to pay all costs of producing avgas. These costs included assuming contingent future regulatory costs in return for the refining industry’s agreeing

¹ Harold S. Ickes, *Fightin’ Oil* at 111 (1943).

to invest in needed facilities, accepting only a minimal profit, and agreeing to be bound by governmental restrictions on the specific products and amounts refiners could produce and sell to the private market. This “grand bargain” became known as the “Avgas Program.” It was implemented in part through three-year minimum supply contracts between the Defense Supply Corporation (DSC) and refiners and through far-reaching control over the refining industry by the Petroleum Administration for War.

By September 2, 1945, V-J Day, the Avgas Program was producing a stunning 540,000 barrels per day of avgas for the war effort. It was lauded by WWII military chiefs and government officials alike who stressed that “[t]he fulfillment of this gigantic task was without question one of the great industrial accomplishments in the history of warfare” and that “[n]o government agency and no branch of American industry achieved a prouder war record.”²

The Issues

Shell Oil Company et al. v. United States, 751 F.3d 1282 (Fed. Cir. 2014) is the culmination of an eight-year saga of governmental attempts to renege on the “grand bargain” it made with refining companies more than 70 years ago in the DSC avgas supply contracts. *Shell Oil* involved four California refining companies³ (or predecessor companies) who contracted with the DSC during WWII to produce avgas. The production of avgas at the four company refineries resulted in substantial waste materials integral to the avgas refining process that were disposed of at an offsite location during WWII now known as the McColl superfund site in Fullerton. Over 50 years after the avgas contracts were signed, the government sought to hold these refiners liable for the cleanup of the avgas waste at the McColl site under the federal Comprehensive Environmental Response, Compensation and Liability Act (CERCLA). As a result, the refiners had to spend nearly \$90 million dollars in cleaning up the avgas waste.

In February 2006, the refiners brought an action in the U.S. Court of Federal Claims seeking to recover the McColl site cleanup costs, claiming that the WWII DSC avgas supply contracts required reimbursement under a provision entitled “Taxes.” They claimed that the provision was not limited to tax reimbursements because the contracts obligated the government to pay “any new or additional taxes, fees or charges... which Seller may be required by any municipal, state or federal law...to collect or pay by reason of the production, manufacture, sale or delivery” of avgas. The refiners argued that the McColl cleanup costs were new “charges” imposed by Congress under CERCLA that they incurred because of the production and manufacture of avgas under the DSC avgas contracts. Thus, they argued that the government was obligated to reimburse the McColl cleanup costs.

The government disagreed, arguing that i) the “Taxes” section applied to tax-like costs only; ii) that to interpret the section differently would impose an unlimited duty to indemnify that was not manifested in the avgas contracts; and iii) the Anti-Deficiency Act⁴ (ADA) barred recovery because Congress did not appropriate funds for the claimed costs. Ultimately, the Court of Federal Claims ruled for the government on all issues and the case was appealed to the U.S. Court of Appeals for the Federal Circuit.

² Tide Water Associated Oil Co., Annual Report 1945 at 1 (Mar. 29, 1946).

³ Shell Oil Company, Atlantic Richfield Company, Texaco Inc. and Union Oil Company of California. Texaco and the Union Oil Company have since been acquired by Chevron Corporation and Atlantic Richfield Company has been acquired by BP.

⁴ 31 U.S.C. §665 (1940) (now revised and codified at 31 U.S.C. § 1341).

The Federal Circuit's Decision

In a 2-1 decision, the Federal Circuit reversed and remanded the case back to the Court of Federal Claims. The Court agreed with the refiners on liability, ruling that the contractual term “charges” encompasses CERCLA cleanup costs and that the claim was not barred by the Anti-Deficiency Act. However, on the issue of allocation of the cleanup costs between the refiners and the government, the court remanded to the Court of Federal Claims, ruling that factual issues in dispute had to be resolved by the court below.

The court's decision is noteworthy in three respects. First, in a remarkable opening passage, the Court demonstrated that it was able to “return” to 1941 and analyze this case from the historical reality of the exigent circumstances of the time. Too often, courts are unwilling to judge intent from the period context from which the roots of the dispute have their origin. Judge Wallach wrote: “A nation of pragmatists, we tend to forget our history until necessity revives our memory. To resolve this contract claim... we must recall and place into context the atmosphere of stark determination for victory at all costs, which drove our war effort” after Pearl Harbor. The court even noted the “grand bargain” by stating that the refiners “agreed to the avgas low profits in return for the Government's assumption of certain risks outside of the [refiners] control.”

Second, the court was true to its interpretive function and followed traditional rules of contract interpretation to reach the conclusion that the clause “any new or additional taxes, fees or charges” is not limited to simply taxes or tax-related items as the Court of Federal Claims ruled, but is broad enough to include CERCLA cleanup costs incurred “by reason of the production of” avgas. As precedent requires, the court considered the relevant clause as a whole, applied the “plain meaning” of the contractual terms, and interpreted the contract in a manner that gives meaning to all of its provisions. Thus, the court found that the plain meaning of the term “charge” meant cost and CERCLA is a federal law that requires responsible parties to pay the “costs of removal or remedial action.”⁵

In so ruling, the court also rejected two important government contentions: (i) that it was not foreseeable at the time of contracting that Congress would have enacted CERCLA and that the contracts were limited to “foreseeable” claims, and (ii) extrinsic contemporaneous evidence that other WWII contracts had both a specific “hold harmless” clause and a promise to reimburse for applicable taxes and charges supported the government's position. As to the former, the court ruled that in contracts for which indemnification was available for all claims, Circuit precedent rejected reading a foreseeability requirement into such contracts.⁶ Here the contracts referred to reimbursement of “any new ... charge.” As to the latter, the court ruled that because the government did not establish that the contracts were ambiguous, extrinsic evidence was improper to interpret the contract but noted that other contemporaneous communications between the parties used the term “charges” and costs interchangeably.

Third, the court disagreed with the court below that the ADA prohibited reimbursement of new or additional charges. The Federal Circuit held that the ADA did not bar the avgas contracts' reimbursement provision of “any new or additional charges” because the contracts at issue were authorized by Congress in the First War Powers Act⁷ and Executive Order 9024 (Jan. 17, 1942) and simultaneous delegating letters to the DSC. While the Court of Federal Claims held that “none of these sources provided the requisite waiver that would allow the government to indemnify the Oil Companies,” the Federal Circuit ruled that only proof of “authorization” was required and not “waiver.”

⁵ 42 U.S.C. § 9607 (a) (4) (A).

⁶ *E.I. Du Pont de Nemours & Co. v. United States*, 365 F.3d 1367, 1373 (Fed. Cir. 2004).

⁷ Pub. L. No. 77-354, ch. 593, §201, 555 Stat. 838, 839 (1941).

The ADA is a criminal statute that provides that unless “authorized by law,” “no executive department shall expend in any one fiscal year, or involve the Government in any contract for the future payment of money in excess of [Congressional] appropriations.” Through a straightforward reading of the First War Powers Act, Executive Order 9024, and an authorizing letter from the War Production Board (WPB) Chairman to the DSC, the court found that these documents authorized the avgas reimbursement provision. The First War Powers Act granted the President authority “to authorize any department or agency” to enter into contracts that would otherwise violate the ADA. The court found that President Roosevelt delegated this power to the WPB through Executive Order 9024 which authorized the WPB Chairman to direct “the policies, plans, procedures and methods” with respect “to war procurement and production, including contracting, specifications, and construction.” The court then found that the WPB Chairman delegated this power by authorizing letter to the DSC, authorizing the DSC “to determine ... the other terms and the form of such [avgas] contracts.”

Conclusion

In reaching this decision, the Federal Circuit rejected each of the Court of Federal Claims’ justifications for denying the refiners’ demands for reimbursement. In so doing, the court preserved the “grand bargain” that industry and government made which was instrumental in our Nation’s victory over the Axis Powers. Only time will tell whether this important decision will have precedential value for the other one-hundred household name corporations that formed similar WWII partnerships with the government that were so essential to the Allies’ triumph.

Government should embrace rather than disavow these bargains that it made during WWII. This is not the first time that the government has sought to turn away from its WWII obligations. In upholding the government’s liability under a similar arrangement regarding the manufacture of synthetic rubber during WWII, the U.S. Court of Appeals for the Ninth Circuit scolded the government for trying to shift the environmental cleanup costs to the company. The court stated: “This is a shocking case. The government is trying to take money from the firms it conscripted for a critical part of a great war effortNow the government wants its servants to pay for what it told them to do and promised them they could do with no fear of liability.”⁸ The American justice system is not perfect, but *Shell Oil* stands as a shining example of its working well to curb arbitrary governmental decisions.

⁸ *Cadillac Fairview/California Inc. v. Dow Chemical Co.* 299 F 3d 1019, 1029 (9th Cir. 2002).