American Bar Association Contract Claims and Dispute Resolution Committee

Most Important Cases of 2020

Exxon Mobil Corp. v. United States of America, Civil Action No. H-10-2386 and H-11-1914, Slip Op., S.D. Tx, September 16, 2020, 2020 WL 5573048, *appeal filed by Exxon Mobil Corp. v. United States of America*, 5th Cir., November 13, 2020

By Susan Warshaw Ebner[1]

During the period leading up to and during World War II and the Korean War, Exxon Mobil Corp.'s predecessor entities ("Exxon") were pressured and directed by the United States Government ("USG") under wartime contracts into converting their facilities and producing a slate of products in connection with making aviation gas ("avgas") and other essential war products. During the process of performing these requirements, waste products were generated. In 2010 and 2011, Exxon sued the USG in the U.S. District Court for the Southern District of Texas under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, 42 U.S.C. § 9601 et seq. ("CERCLA"), seeking to obtain reimbursement from the USG for a percentage of the costs that Exxon paid, and will continue to pay, to remediate environmental damages at its Baytown and Baton Rouge refineries and nearby chemical plants under the Resource Conservation and Recovery Act, 42 U.S.C. §6901 et seq. ("RCRA").

At issue in the Exxon case is whether and, if so, to what extent, a government contractor can recover from the USG a share of the costs to remediate environmental pollution that arose in performance of war-time government contracts where the USG exerted pressure and control over Exxon's performance. The Exxon case raises questions about damages and proportionate liability where there is government pressure and control, as well as the handling and disposition of cases using historical forensic experts.

I. Case Background

In the 1940s, Exxon's predecessor converted certain refineries and chemical plants in Baytown, Texas and Baton Rouge, Louisiana for the production of avgas and synthetic rubber. "The conversion was important to the military victory over Japan and Germany. Both refineries operated under wartime contracts with the United States. In both, military needs were given priority over environmental consequences." *Exxon Mobil Corp. v. United States of America*, Civil Action No. H-10-2386 and H-11-1914, Slip Op., S.D. Tx, September 16, 2020, 2020 WL 5573048 ("*Slip Op*") at 2.

In 1987, the Louisiana Department of Environmental Quality ("LDEQ") issued a Corrective Action Order directing Exxon to conduct environmental cleanup at the Baton Rouge refinery and in 1995, the Texas Natural Resources Conservation Commission, now the Texas Commission on Environmental Quality ("TCEQ") issued an Agreed Order instructing Exxon to clean up numerous sites included contaminated areas at the Baytown refinery. *Exxon Mobil Corp. v. United States,* 101 Fed. Cl. 576 (2011) at 579 (*"Exxon COFC"*). Exxon has incurred environmental cleanup costs

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since then. *Id*. Exxon applied to the U.S. General Services Administration for reimbursement of environmental cleanup costs incurred in the performance of the government contracts. *Exxon COFC* at 579. The GSA never responded to the claims. *Id.*

In 2009, Exxon brought two contract cases against the USG at the U.S. Court of Federal Claims ("COFC"), seeking "recovery for avgas-related environmental cleanup costs based on a reimbursement clause in the World War II avgas supply contracts between Exxon and the government. The clauses [contained in the Master Suppliers Contract ("MSC")] required the government to reimburse Exxon for charges incurred 'by reason of' the avgas production. *See Exxon Mobil Corp. v. United States*, 101 Fed. Cl. 576 (2011)." *Slip Op* at 2. In the *Exxon COFC* case before Judge Smith, the parties moved for partial summary judgment on the issue of entitlement. In that case, Judge Smith held that the facts of the Exxon case

> follow in the footsteps of … [*Shell Oil Co. v. United States*, 93 Fed. Cl. 439 (Fed. Cl. 2010)] in which this Court previously decided the issues now raised again by the Defendant. Although this Court considered CERCLA in Shell, whereas this case concerns state law, the facts and analysis are the same and prompt this court to follow its holding in Shell. As in Shell, the very purpose of the contract clauses at issue was to remove the potential risks any reasonable producer would be reluctant to take on.

Exxon COFC at 581. The COFC granted partial summary judgment in favor of Exxon on the issue of entitlement, leaving discovery and the issue of quantum for later resolution.

In 2010 and 2011, Exxon filed the instant lawsuit in the U.S. District Court for the Southern District of Texas, suing the USG under CERCLA to obtain reimbursement from the USG for a percentage of the costs that Exxon paid and will continue to pay to remediate environmental damages at its Baytown and Baton Rouge refineries and nearby chemical plants under RCRA. Exxon entered into administrative settlements with the State of Texas under CERCLA. In its lawsuit, Exxon alleged that the environmental wastes were attributable to wartime-related efforts during World War II and to a lesser extent the Korean War and the USG should contribute to the payment of those costs. Pending resolution of this case, the U.S. Court of Federal Claims cases were stayed. *Slip Op*. at 2.

II. CERCLA

CERCLA was enacted to promote timely cleanup of hazardous waste sites and ensure the costs of that cleanup were borne by those responsible for the contamination. *Slip Op* at 54. It also provides that there are four categories of responsible parties that may be liable for these cleanup costs:

- Owners and operators of facilities at which hazardous substances are located
- Past owners and operators of facilities when the disposal of hazardous substances occurred
- Persons who arranged to dispose of or treat hazardous substances
- Transporters of certain hazardous substances.

42 U.S.C. 9607(a)(1)-(4). CERCLA was amended to provide that a party could seek contribution for payment of cleanup response costs:

> Any person may seek contribution from any other person who is liable or potentially liable under [§ 107(a)], during or following any civil action under [§§ 106 or 107(a)] .... In resolving contribution claims, the court may allocate response costs among liable parties using such equitable factors as the court determines are appropriate....

42 U.S.C. § 9613(f)(1). Case law indicates that there is no "exhaustive list of criteria" for the equitable factors to be considered in determining liability and cost allocation for such contribution. *Slip Op*, at 55.

III. District Court Litigation

The Exxon case was litigated in three phases:

In the first phase, in response to cross-motions for summary judgment, the District Court found, in pertinent part, that 1) the three-year statute of limitations under CERCLA applied to Exxon's claims involving the Baytown refinery, 2) CERCLA's contribution provision provides Exxon an exclusive remedy for seeking cleanup costs incurred in response to an administrative settlement with the State of Texas, 3) Exxon and the USG were CERCLA owners and operators of the chemical plants, 4) the USG was not a CERCLA owner or operator of either refinery, 5) Exxon is entitled to a declaratory judgment that "the United States is liable for its equitable share of past and future cleanup costs incurred at the Baytown and Baton Rouge sites." *Slip Op*. at 3, quoting *Exxon Mobil Corp. v. United States*, 108 F. Supp. 3d 486 (S.D. Tex. 2015).

A. Allocation Methodology and Factors to Consider

In the second phase, the District Court determined the methodology to allocate the remediation costs at each site as between the USG and Exxon. In that decision, the District Court decided to employ an allocation methodology – a "production-based analysis" -- to determine allocation of costs between Exxon and the USG. *Slip Op*. at 3. General steps under this methodology include:

- assigning shares of waste to the various years of plant operation;
- determining what part of the costs were to clean hazardous wastes caused during the periods of the government's involvement and are attributable to the production of war products, for which the government is responsible, as opposed to wastes caused by Exxon's production of nonwar products for commercial sale;
- determining what part of the costs were to clean hazardous wastes caused by the delay in constructing environmental protections at the refineries and plants, and what part of the delay is attributable to Exxon or to the government; and
- assigning the wartime-related costs subject to allocation based on the parties' respective degrees of involvement with the wartime activities and other equitable factors.

Slip Op. at 3-4. The District Court also determined to employ the following factors for its equitable allocation analysis:

- the "Gore" factors, which include:

  • (i) the ability of the parties to demonstrate that their contribution to a discharge, release or disposal of a hazardous waste can be distinguished;

  • (ii) the amount of the hazardous waste involved;

  • iii) the degree of toxicity of the hazardous waste involved;

  • (iv) the degree of involvement by the parties in the generation, transportation, treatment, storage, or disposal of the hazardous waste;

  • (v) the degree of care exercised by the parties with respect to the hazardous waste concerned, considering the characteristics of such hazardous waste; and

  • (vi) the degree of cooperation by the parties with the federal, state or local officials to prevent any harm to the public health or the environment;

• the "Torres" factors, which include:

  • the extent to which cleanup costs are attributable to wastes for which a party is responsible;

    • the party's level of culpability;

    • the degree to which the party benefitted from disposal of the waste; and

    • the party's ability to pay its share of the cost; and

  • other factors, including:

    • the knowledge and acquiescence of the parties in the contamination-causing activities;

  • the value of the activities to the national defense efforts;

  • the parties' roles at the refineries and chemical plants;

  • the parties' intent to allocate liability; and

  • post-war waste handling improvements.

Slip Op. at 4. In that second phase, the District Court also held that Exxon is entitled to recover future cleanup costs at these units. Id.

In the third phase, which resulted in the current decision, the parties stipulated to certain cost-accounting issues, as well as "run-rate" costs for each site to be treated as future costs, and size of the offset for insurance. Thus, issues addressed in the third phase were limited to:

> • the allocation of responsibility for cleanup costs at the various units, including a determination of:
>
> > • the percentages of wartime production related to "war products" as opposed to "commercial" products;
> >
> > • the adjustments for Exxon's post-wartime waste-management improvements; and
> >
> > • the application of the equitable-allocation methodology set out in the court's Phase 2 opinion to determine what amount each party must pay;
>
> • whether an amount offseting Exxon's equitable share of liability based on the North American Coverage Case settlement proceeds is needed; and
>
> • whether Exxon may recover prejudgment interest, "run rate" costs, and consultant costs.

Slip Op. at 5.

B. Use of Historical Forensic Experts

To establish facts, since there were no live witnesses or detailed records, the District Court permitted the use of forensic historians to assemble the records and explain their bearing on questions presented. *Slip Op*. at 8. The facts below were determined by the District Court based on its determination of the credibility and reasonableness of the historians' assessments.

Among the key findings of fact were:

- The USG emphasis on maximizing production of avgas and other wartime products required Exxon to defer or forgo maintenance and repairs that would require shutting down all or part of the refinery and related facilities.

- Oil refining is messy. It produces oil, water, and other substances that create toxic sludges and contaminated water.

- The USG used executive and other powers to pressure refinery owners and operators to convert to producing wartime products, and companies like Exxon responded to the mixture of patriotism and pressure.

- The USG exerted control over the materials and manpower essential to refinery operations, as well as refinery operations.

- USG restrictions on materials and manpower made refineries unable to install pollution controls during the war years. Similarly, USG insistence on running the plants 24 hours a day, 7 days a week, year round, made refineries unable to make timely repairs or

perform routine maintenance. These USG requirements also increased hazardous waste production.

- In 1935, Exxon entered into a contract with the Army Air Corps to produce 100-octane gasoline. New processing plants and machinery were needed for this. As of 1940, national refineries were producing 40,000 barrels of 100-octane gasoline a day, far short of the amount that would be needed after Pearl Harbor. *Slip Op.* at 9.

- "War changed almost everything, including how refineries operated and what they produced. The immediate, urgent, and large need for aviation gasoline for the national defense effort drastically changed the amount of production across the nation. The government encouraged and, in many ways, effectively required, the refineries' private owners and operators to convert as fast as possible to making as much high-octane avgas as possible. By appealing to patriotism, and by making it clear that access to materials and resources needed for refining in general depended on supporting the war effort, the government obtained what it needed—a huge and fast increase in the amount of avgas and other essential wartime products for military use." *Slip Op.* at 10.

- The USG first established the Office of Petroleum Coordinator, which issued "recommendations" and "directives" to the petroleum industry. It required refineries to prioritize production of avgas by, inter alia, restricting the use of blending agents to aviation gasoline, boosting alkylate products to increase 100-octane avgas production, restricting allocation of key materials for avgas production, issuing priority orders, preference ratings, and quotas for essential materials. *Slip Op* .at 10-11. The USG then established the Petroleum Administration for War, which issued "petroleum directives" and "petroleum administrative orders" governing production, refining, treating, storage, shipment, receipt and distribution of petroleum, petroleum products or associated hydrocarbons, etc. This Petroleum Administration acted as the sole purchaser of avgas from the nation's petroleum industry and controlled the industry. *Id.*

- The Court found that, in the 1940s, "the government effectively left the companies no choice in contracting to make and supply avagas, and little room to maneuver on contract terms." *Slip Op.* at 11. And, there was in fact no "freedom to make a choice between contracting and not contracting." *Id* at 12. If you didn't make the avgas products you were not able to run your refineries. "The Administration 'coordinated and supervised' the activities of private companies' refineries as 'units of one enterprise and directed their operations so as to product the maximum quantities of aviation gasoline at the earlier possible time.' " *Id.* at 12. Compliance required posting routine inspection and maintenance, and minimizing downtime. The USG denied requests from the refineries for improved waste-handling systems on the ground that such improvements would distract from or interfere with operations "vital to the war program." *Id.*

- Also in the 1940s, the War Department acquired land adjacent to the Baytown refinery to build and operate the Baytown Ordnance Works. This facility was constructed at

USG direction and according to its specifications. Id.at 17. In 1955, most of it was purchased by a predecessor to Exxon. Id. at 18.

- In addition to avgas, these refineries produced chemicals and feedstocks necessary to the war effort, including toluene and synthetic rubber which were needed for ordnance and other military and civilian requirements. Id. at 13-14.

- The USG also owned and/or operated sites, including jointly operated or used plancors[2], by the refineries and chemical sites, which generated additional hazardous products/wastes. Id. at 33-35.

- After VJ Day, extensive federal government control over the petroleum industry ended, but government involvement continued in order to ensure a ready supply of petroleum products in the event of another war. Id. at 15.

- The Korean War in the 1950s heightened the need for war materials from 1950 to 1953. The Defense Production Act, passed in 1950, granted the President authority to force industry to prioritize producing materials needed for national security. Id. at 15.

- Environmental controls and requirements were instituted in the 1950s, 1960s, and 1970s, including enactment of RCRA in 1976 and CERCLA in 1980. Texas and Louisiana also passed laws on regulating refineries. CERCLA, for example, was designed to "promote the timely cleanup of hazardous waste sites and to ensure that the costs of such cleanup efforts were borne by those responsible for the contamination." Id. at 16.

- With regard to the allocation methodology needed to determine entitlement as well as quantum in the case, Exxon proposed allocation methods based on "production" while the USG proposed "time-on-the-risk" model. Id at 19. The Court determined that the production method was more credible and employed that in this third phase of the case.

- The Court determined that the kind, amount, location of the environmental wastes over time, as shown through historic forensic examination, established a federal nexus to the contamination that had to be remediated.

Slip Op. at various pages, e.g., 7-35.

C. District Court Determination of Equitable Allocation Using Equitable Factors

[2] Though none of the Exxon case decisions appears to define the term "plancor", it appears to refer to the industrial facilities established by the Defense Plant Corporation ("DPC") ; the DPC was established in 1940 to set up industrial facilities for the war effort. https://www.archives.gov/research/guide-fed-records/groups/234.html#234.5.2. The word "plancor" is apparently a contraction of the Plant Corporation established. *See, e.g*., http://what-when-how.com/the-american-economy/defense-plant-corporation-dpc/. Facilities were assigned different plancor numbers as an official designation of a DPC project. The *Slip Op.* uses different plancor numbers to refer to the different industrial facilities owned or operated by the USG and at issue in these cases.

With regard to equitable allocation, using equitable factors, the District Court found:

1. **The Knowledge and Acquiescence of the Parties in the Contamination-Causing Activities** - The USG had knowledge that the consequences of its directives would lead to contamination-causing activities and, by its orders and directives, acquiesced in the contamination-causing activities. *Slip Op*. at 45. Though the USG may not have known the full impact of the expanded wartime production and limited waste handling procedures, it knew that the war material production it required, directed, or participated in during the years of federal involvement would have a lasting and extreme environmental impact. The USG made the decision that winning the war was a benefit outweighing the environmental risks and costs. *Id.* at 46-47. This supports a significant allocation of costs to the USG.

2. **The Value of the Activities to the National Defense Efforts** – It was undisputed by the parties that the activities in question had value to the National Defense efforts, which the District Court found supports a significant allocation of costs to the USG. Id. at 47.

3. **The Parties' Roles at the Refineries and Chemical Plants** - While the District Court found that Exxon, not the USG, was a CERCLA plant operator of the refineries, it determined that the USG was significantly involved in the activities and this established a nexus to the contamination. The District Court also found that the USG was an operator of the plancors at both refineries and "[t]he government's direction of certain aspects of the synthetic-rubber plant operations and the waste disposal activities make it liable as a prior operator." *Id.* at 47. However, the fact that Exxon continues to operate these sites and produce wastes and contribute to response costs incurred or to be incurred in the 1980s and beyond, were determined to be a factor supporting a lower equitable share for the USG. Id.

4. **The Parties' Intent to Allocate Liability** – The District Court looked at the three USG-Exxon contracts for producing avgas during World War II to determine "whether there is an indemnification agreement demonstrating 'the parties' intent to allocate liability among themselves.' *Halliburton Energy Servs., Inc. v. NL Indus.*, 648 F. Supp. 2d 840, 863 (S.D. Tex. 2009)." Id at 48. The first and third contracts with the Defense Supplies Corporation and Exxon were supply contracts which contained a Master Suppliers Contract ("MSC"). The MSC contained a provision:

   > Buyer shall pay in addition to the prices as established in Sections IV and V hereof, any new or additional taxes, fees, or charges, other than income, excess profits, or corporate franchise taxes, which Seller or its Suppliers may be required by a municipal, state or federal law in the United States or any foreign country to collect or pay by reason of the production, manufacture, sale or delivery of the commodities delivered hereunder.

   Id. at 49.

   The District Court followed the reasoning of the U.S. Court of Appeals for the Federal Circuit in *Shell Oil Co. v. U.S.*, 751 F.3d 1282, 1293 (Fed. Cir. 2014), which had previously interpreted this MSC language and determined that it required the USG to reimburse Exxon

under its avgas contracts for CERCLA charges incurred "by reason of the production, manufacture, sale or delivery of [avgas]":

> The Federal Circuit interpreted "charges" to include "costs" and found that the plain language of the contract provision meant that "CERCLA costs are 'charges' within the meaning of the relevant contract provision[:].... The avgas contracts promise reimbursement of 'any new or additional ... charges' the government imposes on the Oil Companies 'by reason of the production, manufacture, sale or delivery of [avgas].' " *Id.*

Slip Op. at 49.

5. **Post War Waste-Handling Improvements** - The District Court found that there was credible evidence that Exxon had implemented numerous waste-improvement programs at the refineries after the period of federal involvement, which supports allocation of increased remediation costs to the USG. *Slip Op*. at 50.

Based on this analysis, the Court determined that allocation of costs to the USG was appropriate. It applied the Exxon experts' forensic calculations, but adjusted them by 5% for each refining facility (Baytown and Baton Rouge) based on the USG role in the refineries compared to Exxon's role, as well as the limitations of being able to measure the effort of the waste-processing improvements achieved between the period 1950 through the 1980s. It found and concluded that, after considering all equitable factors, the USG was liable under CERCLA for an allocated share of 24.67 percent for past response costs at Baytown and 14.4 percent for past response costs incurred at Baton Rouge. *Slip Op*. at 56.

Because the USG owned the Baytown Ordnance Works site, the Court did not reduce the allocation costs to the USG for that site. It found and concluded that, after considering all equitable factors, the USG was liable under CERCLA for an allocated share of 36.54 percent for past response costs incurred at Baytown Ordnance Works/Tankfarm 300 Area. *Slip Op.* at 56.

D. District Court Award of Interest

Having established the amount of the allocation of the remediation costs to be funded by the USG and that the remediation costs had been paid by Exxon, the District Court also directed the USG to pay interest on the allocated amounts at the rate mandated by CERCLA.

E. District Court Awards Declaratory Judgment for Already Incurred Past Remediation Costs On Which Evidence Had Been Provided

The District Court also issued a declaratory judgment to assign the government the same allocation of costs for the units that Exxon had already incurred past remediation costs. However, the District Court refused to enter a declaratory judgment for remediation for adjacent waterbodies or units where Exxon had not already incurred past response costs or provided evidence of past response costs, on the ground that the facts had not been sufficiently developed.

F. Insurance Offset

CERCLA prohibits a double recovery. However, the District Court did not reduce the amount of costs awarded to Exxon even though it received insurance proceeds for the two facilities at issue based on Exxon representations that it would not obtain a double recovery unless the Court allocated to the USG more than 94 percent of Exxon's claimed past costs of $51.0 million at Baytown ($48.1 million) or more than 87 percent of Exxon's claimed past costs of $26.0 million at Baton Rouge ($22.7 million*). Slip Op*. at 53.

Thus, the District Court issued a total damage award in favor of Exxon in the amount of $20,328,670, plus declaratory judgment in favor of Exxon against the USG for a percentage allocation for costs incurred for units at which Exxon has already incurred past response costs as described in the bench trial.

IV. Lessons to be Learned

Government contractors may be required to operate in wartime, contingency or emergency environments. The current pandemic poses challenges for contractors that are required to perform their government contracts under schedules or demands set by rated orders or other USG direction. Speed in meeting these requirements is crucial. However, as the *Exxon* case points up, contractors should check to see if their contracts contain indemnification provisions to address unforeseen consequences of performing such time-sensitive or national security requirements.

Additionally, where the contract or underlying statute permits recovery, but does not layout the precise methodology upon which to allocate such costs, there may be a number of factors to consider. Careful documentation and record-keeping of your actions, the USG direction, and your impacts and costs can mean the difference between recovery or future liability.