United States Court of Appeals, Federal Circuit.

CITY OF **LONG BEACH** and STATE of California, Plaintiffs-Appellants,

v.

EXXON CORPORATION, Defendant-Appellee.

No. 97-1045.

June 10, 1998.

Before MAYER, Chief Judge,[FN*] ARCHER, Senior Circuit Judge, [FN*] and MICHEL, Circuit Judge.

FN* Chief Judge Haldane Robert Mayer assumed the position of Chief Judge on December 25, 1997.

FN* Senior Circuit Judge Glenn L. Archer, Jr. vacated the position of Chief Judge on December 24, 1997.

DECISION

ARCHER, Senior Circuit Judge.

***1** The City of Long Beach and the State of California (collectively Long Beach) appeal from the judgment entered on September 18, 1996 by the United States District Court for the Central District of California, holding Long Beach liable under the Economic Stabilization Act (ESA), 12 U.S.C. § 1904 note (1970), for overcharges on oil sold to Exxon Corporation (Exxon) during the period September 1, 1973 to October 25, 1973. The court also awarded treble damages, attorney fees, and costs to Exxon on the basis that Long Beach's overcharges were intentional. Because the state and local government exemption in the applicable price control regulations exempted Long Beach from price controls on the sale of its oil, we *reverse.*

BACKGROUND

In 1965, Long Beach and a consortium of oil companies, Texaco, Humble (now Exxon), Union, Mobil, and Shell (collectively THUMS), entered into a Contractors' Agreement for the development, production and sale of the crude oil reserves from Tract 1 of the Long Beach Unit, Wilmington Oil Field, which was owned by Long Beach (and beneficially by the State of California). Under the Agreement, Long Beach agreed to sell to THUMS (subject to the "sell-off" oil provision described below) and THUMS agreed to purchase 80% of the crude oil produced from Tract 1. The price that THUMS was required to pay Long Beach was determined by a complex formula set out in the Agreement, which was designed to reflect a percentage of the net profits after production costs. In general, field prices at the Wilmington field and three nearby fields were used to determine a value for the crude oil and then all production costs were subtracted to arrive at the net profits. THUMS was required to pay Long Beach 95.56% of the net profits so determined for the oil it was required to purchase. Because of the pricing calculation, this 80% of the crude oil produced was referred to as "net profits" oil.

Instead of receiving the price based on net profits, however, Long Beach had the right to direct THUMS to sell off 12.5% of the net profits oil to other purchasers at competitive prices. This was called "sell-off" oil. The remaining 20% of the oil produced was the share of royalty owners who had the right to take the oil in kind, or permit it to be sold to others at competitive prices, which was called "in-kind royalty" oil.

In 1970, Congress passed the ESA, which, *inter alia,* authorized the President to establish price ceilings for domestic crude oil. Four phases of price control regulations were implemented by the Cost of Living Council (CLC) over the period that price controls were in effect. The Phase II regulations provided an exemption from price controls for "price adjustments" on the sale of commodities, including oil, by state and local governments. *See* 37 Fed.Reg. 1237, 1241 (1972) (codified at 6 C.F.R. § 101.34(a)(2)). The Phase III regulations contained a similar exemption. Long Beach asserts that the sale of net profits oil was exempt under the Phase II and III regulations, but that it could not benefit because the net profits price in the Agreement was based on oil prices at the pertinent fields, all of which were controlled prices. Long Beach, however, was able to receive an uncontrolled price under the state and local exemption during Phases II and III for its sell-off oil.

***2** The Phase IV regulations continued to exempt state and local governments, but the exemption language was changed. Instead of exempting price adjustments the regulations exempted

[p]rices and fees charged by State and local governments for any work, service, publication, report, document, benefit, privilege, authority, use, franchise, license, permit, certificate, registration, facilities, materials, or similar thing of value or utility, performed, furnished, provided, granted, prepared, issued, or transferred ... except, however, that fees or charges for health services ... are not exempt under the provisions of this section.

6 C.F.R. § 150.54(a)(2) (1973).[FN1]

FN1. Under the Emergency Petroleum Authorization Act (EPAA) of 1973 (15 U.S.C. § 275 et seq. (1976)), the Federal Energy Office (FEO) was created to administer the EPAA. The chairman of the Cost of Living Council delegated the authority with respect to energy matters to the FEO. FEO later adopted its own regulation exempting state and local governments from price controls on crude oil, a covered product, as follows: "Prices charged for any sale, lease or lease-sale of a covered product by State and local governments are exempt." 39 Fed.Reg.1952 (1974) (codified at 10 C.F.R. § 212.52(b)). On February 25, 1974, the FEO revoked the state and local exemption effective retroactively to October 25, 1973. *See* 39 Fed.Reg. 7176, 7176-77 (1974). Before delegating its authority to the FEO, the CLC had filed a notice in the Federal Register on October 26, 1973 proposing such a revocation of the state and local government exemption. *See* 38 Fed.Reg. 29,618, 29,618-19 (1973).

In order to encourage production of additional domestic crude oil, the Phase IV regulations exempted certain classes of oil, resulting in a private market with uncontrolled prices. The regulations used the amount of oil produced at a given property during the corresponding month in 1972 as a baseline. Any "new crude oil," *i.e.*, any oil produced in excess of this baseline amount, was exempt from the price controls. Moreover, an additional amount of oil equal to the amount of the new crude oil, called "released crude oil," was also exempt. Thus, only the "old crude oil," *i.e.*, the baseline amount of oil minus the amount of released crude oil, remained subject to price controls.

Considering itself exempt under the state and local government exemption, Long Beach began as of September 1, 1973 charging THUMS for its net profits oil an amount based on the prices for uncontrolled oil, *i.e.*, so-called new crude and released crude oil, at the designated fields. THUMS objected, but nevertheless signed an agreement with Long Beach under which THUMS made payments based on the uncontrolled oil prices but preserved its right to challenge the applicability of the state and local government exemption to the net profits oil. The agreement also waived any prejudgment interest if any price overcharges were later determined to be payable to THUMS.

Long Beach sued the THUMS consortium for antitrust violations in 1975, and the THUMS consortium members later counterclaimed for price overcharges by Long Beach with respect to the net profits oil.[FN2] In 1984, the district court granted partial summary judgment, holding that Long Beach's sales of net profits oil were not exempt from price controls. The court determined that the exemption applied only if (1) the state or local government had the unilateral right to adjust the price it received for the oil and (2) the benefit of the exempt oil redounded exclusively to the state or local government, neither of which was met. In 1995, the district court held a bench trial in which it considered whether Long Beach acted in a criminally willful manner in making the overcharges, whether Exxon had made a bona fide claim for a refund, and whether the court should award Exxon treble damages, reasonable attorney fees, and costs. The court held in favor of Exxon on these issues and entered judgment against Long Beach.

FN2. *The antitrust allegations were the subject of extensive litigation, but they are not an issue in this appeal. Further, the counterclaims of the members of the THUMS consortium, other than Exxon, were settled in 1991.*

DISCUSSION

***3** A. In this appeal, Long Beach contends that during the relevant period from September 1 to

October 25, 1973, the language of the Phase IV regulations exempting state and local governments from price controls was broad and unconditional and included within its scope the net profits oil sold by Long Beach to Exxon under the Contractors' Agreement. Long Beach argues that the district court erred in drawing a distinction between normal governmental services and proprietary activities and in determining that additional conditions had to be met for sales in the latter capacity to be exempt.

Exxon argues that the district court properly determined that the exemption provision was ambiguous and correctly required that the governmental body must have "the unilateral right to adjust the price and ... receive the entire benefit from any such adjustment." Because the court found these conditions not satisfied, Exxon asserts that the district court correctly held that the exemption did not apply to sales of net profits oil.

In its partial summary judgment finding Long Beach liable for price overcharges, the district court stated:

Also, "Price adjustments ... by State and local governments ..." implies that the adjustments concerned are those that could be made by the government unilaterally in its discretion. Here, Long Beach lacks such authority with respect to its net profits oil. In addition, the text of the regulation does not reveal its applicability if the governmental body would not be entitled to receive and retain the full benefit of any "price adjustment."

In view of the foregoing, I find that the regulation, in itself, fails to express clearly its applicability to the issue here presented, and that therefore it is appropriate to consider the contemporary expressions and actions by the parties concerned as to whether sales of net profits oil were exempt from price controls.

Because it found the two conditions were not satisfied and because it concluded from certain documentary and deposition evidence that the government price control agencies did not consider the sales of net profits oil to be exempt, the district court entered partial summary judgment in favor of Exxon. The court commented, however, that "there appears to have been no document specifically proclaiming that net profits oil was subject to price controls...."

B. We begin our analysis by considering the language of the regulations. If the language of a regulation is clear on its face, it is not subject to alternative construction. *See* *Lockheed Corp. v. Widnall*, 113 F.3d 1225, 1227 (Fed.Cir.1997). The plain meaning of language in a regulation governs unless that meaning would lead to absurd results. *See* *Weddel v. Department of Health & Human Servs.*, 23 F.3d 388, 393 (Fed.Cir.1994); *Genentech, Inc. v. Eli Lilly & Co.*, 998 F.2d 931, 941-42 (Fed.Cir.1993).

***4** The language of the Phase IV regulations is straight forward. It exempted in broad terms "[p]rices and fees charged by State and local governments for any ... materials or similar thing of value or utility ... transferred." 6 C.F.R. § 150.54(a)(2) (1973). The only exception contained in the exemption was for health services. The definitions contained in the regulations similarly indicate that the coverage of the exemption provision was broad. The term "price" was defined as "any consideration for the sale or lease of any property or services and includes rent, commissions, dues, fees, margins, rates, charges, tariffs, fares, or premiums, regardless of form." *Id.* § 150.31. Nothing in these regulations indicates that there were any exclusions from any exemption, other than health services, which were explicitly excluded, or any conditions that had to be met to qualify for the exemption.

In reaching its decision, the district court relied on and interpreted language from the Phase II regulations. Instead of exempting "prices" charged by a state or local government, these earlier regulations exempted "price adjustments." *See* 37 Fed.Reg. at 1241. A price adjustment was defined as "an increase in the unit price of property or services or a decrease in the quality of substantially the same property or services." *Id.* at 1239. Although noting that these regulations using the price adjustment language "do seem to cover '... materials [crude oil] ... transferred ...' by Long Beach," the district court thought that the principal thrust of the regulations was to avoid interference with normal governmental services and that it "seem[ed] very doubtful that the exemption was intended to cover sales of crude oil by Long Beach."

We are not convinced that the Phase II regulations, or the Phase IV regulations which are at issue here,[FN3] are subject to the interpretation made by the district court or the additional conditions it imposed on the state and local government exemption. The district court pointed to no ambiguity in the language or terms in the regulations. And nothing in the regulations suggests that a distinction should be drawn between a state or local government's proprietary and governmental functions or that the regulations were concerned with avoiding interference only with governmental functions. The district court's statement that "[i]t would seem doubtful that the exemption was intended to cover sales of crude oil by Long Beach as one of many producers and sellers of oil in the marketplace where other producers clearly were subject to price controls" is not sufficient to find ambiguity or to go beyond the words in the regulations.

> FN3. *The parties have not drawn any distinction between the exemption language in the Phase IV regulations and the Phase II regulations, but if anything the definition of "price" in the Phase IV regulations is broader and more encompassing than the "price adjustment" definition in the Phase II regulations.*

The distinction the district court drew between proprietary and governmental activities is also at odds with the most probative evidence in the record. The district court acknowledged that Long Beach's sales of sell-off and in-kind royalty oil were exempt. Moreover, the sell-off oil sales were specifically approved as exempt from price controls in an IRS ruling dated June 9, 1972. These sales, drawn from what would otherwise have been sold to THUMS as net profits oil, were made in a proprietary capacity by Long Beach, and in this respect cannot be distinguished from its sales of the net profits oil.

***5** Further, the general counsel of the CLC in a formal opinion to the Attorney General of the State of California dated October 26, 1973, set forth the CLC's interpretation of the exemption language of the regulations by stating:

It is the position of the Council that crude petroleum is included within the word "material" and that a sale by a state is a "transfer" of such material. Therefore, the sale of crude petroleum by a state is within the scope of the exemption.

The district court found this opinion unpersuasive as to whether net profits oil was exempt because the state's inquiry related to in-kind royalty oil and sell-off oil. However, it is persuasive in evaluating whether the regulations were directed only to the governmental functions of the state and city or whether proprietary functions were also exempt. Thus, CLC's position was that the proprietary government activity of selling in-kind royalty and sell-off oil was exempt from price control, even if the broad language of the general counsel's opinion was correctly found by the district court not to cover net profits oil.

Based on the unqualified language of the exemption provision and the other evidence discussed, we conclude that the district court's attempted contrast of governmental functions with proprietary functions for purposes of applying the exemption from price controls on petroleum sales is unpersuasive and incorrect.

C. The district court ruled against Long Beach primarily because two conditions it viewed as necessary for the exemption provision to apply to state and local government sales of petroleum were not satisfied in the case of the net profits oil sales. The court stated that the exemption provision "implies that the [price] adjustments concerned are those that could be made by the government unilaterally in its discretion" and that Long Beach lacked such authority with respect to its net profits oil. The court also said that the regulation does not "reveal its applicability" if the governmental body would not receive and retain the full benefit of any price adjustment. The court thus found ambiguity in the regulation, which required it to consider contemporaneous expressions and actions by the parties as to whether net profits oil sales were exempt from price controls.

As noted earlier, "price adjustments" is not the language of the applicable regulatory provision; rather the applicable Phase IV regulations used the term "price" alone, which was defined broadly in the regulations to mean "any consideration for the sale or lease of *any* property or services." (Emphasis added). 6 C.F.R. § 150.31 (1973). We see no ambiguity in the language of the Phase IV regulations or any need to add conditions to that language. By clear terms, the Phase IV regulations exempt all property (including crude oil) sales by a governmental entity, without reservation, and this would include the sales of net profits oil.

Even if we consider the other evidence of record relied on by the district court we are not convinced that the plain language of the regulations produces an absurd result or necessitates the additional conditions imposed by the district court for the exemption to apply. Before looking at that evidence, we note that the Federal Register notices published both by the CLC and the FEO consistently indicated that state and local governments were exempt from price controls on covered products, which included petroleum. No conditions were mentioned in these notices. Thus, in its October 26, 1973 notice in the Federal Register proposing to revoke the state and local government exemption with respect to crude oil sales, the CLC stated:

***6** Under the existing regulations sales of products including crude petroleum and refined petroleum by State and local governments are exempt from Subpart L price rules for covered products.

38 Fed.Reg. at 29,618. In a later notice, the FEO noted that 137,000 barrels of exempt crude oil had been sold by the State of California and certain cities. This volume included the net profits oil at issue here. *See* 39 Fed.Reg. 12,252, 12,253 (1974); *see also* 39 Fed.Reg. at 7176-77. And previously, we discussed the CLC's General Counsel's letter to the Attorney General of California which broadly described the exemption and did not indicate that any conditions for exemption had to be satisfied.

It is also noteworthy that the Temporary Emergency Court of Appeals (TECA) (whose jurisdiction was given to this court by 28 U.S.C. § 1295(a)(11), (12) (1994)), in the case of *People of the State of California, State Lands Commission v. Simon,* construed the exemption to mean:

By the terms of “Subpart L” [of the Phase IV regulations], all crude petroleum produced in the United States was subject to price regulation.... But an exemption was established for certain prices and fees charged by state and local governments and government property. By interpretation of the agency [the CLC] this exemption covered sale of crude oil by those governments in their proprietary capacities.

504 F.2d 430, 432 (Temp.Emer.Ct.App.1974) (footnotes omitted). The *Simon* opinion gives support to the view that the exemption broadly covered all oil sold by a state or city and was not subject to conditions of any kind.

The two conditions imposed by the district court are the same as representations made in an application filed for an IRS ruling that sell-off oil was covered by the exemption. In the application letter, it was represented that Long Beach would receive the entire benefit of the increased price that would be received from third party purchasers of sell-off oil and that it would have price setting power by being able to accept or reject the competitive bids received. The real issue in the application letter was whether Long Beach's direction to THUMS to sell the sell-off oil under the Agreement made it a sale by an agent on Long Beach's behalf, which would be exempt, or an unexempt sale by the oil companies. The two conditions-that Long Beach had power to control the price and that the entire proceeds of the sale would go to Long Beach-were critical to the IRS's determination that the oil companies were acting as Long Beach's agent in selling the sell-off oil. They were not essential to the application of the exemption from price controls if the agency relationship existed that made Long Beach the seller.

The IRS in its ruling letter recognized that the THUMS consortium acted in three capacities under the Agreement-independent contractor, purchaser, and agent of Long Beach. The ruling stated that the “request for ruling concerns *only the third capacity discussed above* ” (emphasis added), *i.e.*, the agency capacity. The IRS used the two conditions to support the status of THUMS as an agent. In doing so it stated:

***7** The obligation to act as agent is imposed by statute. This is an agency relationship since the Field Contractor [THUMS] is required to pay over to the City of Long Beach the entire amount received from the sale and in no sense could it be said that the Field Contractor has title to that portion of oil it is required by law to offer for sale.... Consequently, we are of the opinion that the prices for crude oil *sold* by competitive bid *by the City of Long Beach* would not be subject to current regulations.

(Emphasis added). In the case of the net profits oil sales, there is no question that Long Beach is the seller. Thus, the two conditions set out in the application letter are irrelevant to a net profits oil sale. Accordingly, the district court erred in reading these two conditions into the exemption provision of the regulations.

Finally, the district court pointed to a memorandum of a staff member of the regulatory agency, certain non-contemporaneous affidavits and testimony of former agency attorneys and an attorney for the oil companies, and inquiries by Long Beach and the State of California as to the application of the exemption to sell-off and in-kind royalty oil to support its conclusion that satisfaction of the two conditions were necessary to exemption from price controls. In the face of clear, unambiguous regulations and contemporaneous, official statements of the regulating agency, little or no weight can be given to the evidence cited by the district court. In

Pennzoil Co. v. United States Department of Energy, the court rejected similar after-the-fact testimony and affidavits of former agency officials noting that "it is worth remembering that opinions are to be given little weight, as such, unless they are institutional in character." 680 F.2d 156, 171 (Temp.Emer.Ct.App.1982). The affidavits and testimony relied on by the district court here were not institutional in character and were not reflective of official agency action.

The district court also relied on statements and inquiries by California and Long Beach to the CLC about the application of the exemption to sell-off and in-kind royalty oil. From the several applications and inquiries that were made seeking assurance of exemption for these categories of oil, the court inferred that the city and state officials did not regard net profits oil to be exempt because net profits oil was not mentioned. We think this inference goes too far and does not establish a legal basis for interpreting the regulatory exemption contrary to its plain words.

For the reasons set out herein, we reverse the judgment of the district court.