Supreme Court of Texas
October 9, 2015

Kachina Pipeline Co. v. Lillis
No. 13-0596
Case Summary written by Alicia McCullar, Staff Member.

JUSTICE BROWN delivered the opinion of the Court, in which JUSTICE JOHNSON, JUSTICE WILLETT, JUSTICE GUZMAN, JUSTICE LEHRMANN, and JUSTICE BOYD joined.

The Court construed two provisions in a contract between a natural gas-producer (Lillis) and a pipeline operator (Kachina). One provision dealt exclusively with the parties' rights and responsibilities as to pressure obligations, while the other concerned an option to continue the arrangement on a month-to-month term following the conclusion of the initial five-year term. The trial court entered summary judgment in favor of Kachina and the court of appeals reversed, holding that the agreement was unambiguous and should be strictly construed by its terms.

During the initial term of the agreement, Lillis was entitled to profits from the sale of gas by Kachina to a third-party, Davis. In order to deliver the gas to Kachina, however, the gas must be sufficiently pressurized to overcome the working pressure in the gathering system. To effectuate such an end, Kachina installed a compression station in 2003, prior to the 2005 agreement between Kachina and Lillis. Subsequently, to meet the needs of Davis, Kachina also installed an additional compression in 2007. The costs of the compression station were pro rated as deductions against the proceeds distributed to Lillis. Lillis claimed that the deduction was not allowed by the terms of the contract. Additionally, Kachina claimed that the "option" term of the contract allowed for a five-year extension beyond the initial term. The initial period expired in May 2010 and continued month-to-month from thereon cancelable at anytime with thirty-days notice. Moreover, before Lillis sold to a third-party following cancellation of the agreement, Kachina could exercise its option to match the third-party proposed price. Lillis contended that the terms of the agreement did not allow for a five-year extension.

Reviewing the declaratory judgment granted on summary judgment de novo, the Court considered the evidence favorable to the non-movant. To indulge the parol evidence presented by Kachina concerning construction of the contract, the reviewing court must determine that the contract is ambiguous. The Court made no such determination. As such, taking a utilitarian approach, the Court determined that the provisions defining "Delivery Point" and "Pressure" were not ambiguous and did not seek the parties' intent to construe those terms. With that finding, the Court determined that the Pressure provision allowed Kachina two options—in the event Lillis's well pressure was insufficient to overcome Kachina's working pressure: Kachina could do nothing (and the well would be released from the agreement) or Kachina could "elect to install compression so that the well [could] overcome the working pressure." Only if Kachina were to elect the second option, did it have the right to deduct compression costs from Lillis's proceeds. Overall, the provision in the contract allowing for deduction of compression costs did not apply to pre-existing compression and it did not apply to Kachina's installation of compression to meet the high-pressure needs of Davis.

The provision allowing for an extension of the term of the contract was also construed by its plain meaning, as ambiguity was not assigned to this provision. After May 2010, following the initial five-year term of the agreement, the agreement operated on a month-to-month basis. If Lillis wanted to cancel the contract following the initial term because he received an offer from a third-party, he was required to give Kachina notice and allow Kachina the opportunity to match the proposed price. Kachina argued that the month-to-month construction yielded an absurd result because Kachina would perpetually need to exercise its option every month to continue to the agreement. The Court, however, concluded that because Lillis was allowed to pursue a better deal at the end of the initial term, Kachina was required to match that price in order to continue purchasing from Lillis. Kachina further raised concerns that the nature of their business was unpredictable and investment costs on a month-to-month basis were unreasonable. The Court concluded that Kachina's return on investment was secured by the five-year term and if Kachina wanted to do business for a longer period of time, it should have included a longer term in the original agreement. The Court held that the initial contract term ended in May 2010 and could not be extended for another five years.

The Court decided that the court of appeals correctly reversed the trial court's holdings, and further, that reversal of attorney's fees awarded by the trial court was also proper. Since the Court affirmed the court of appeals reversal and Kachina lost on two of its primary issues, the Court decided to remand the case to determine an appropriate award of costs and fees.

CHIEF JUSTICE HECHT, joined by JUSTICE GREEN and JUSTICE DEVINE, concurring in part and dissenting in part.

The Chief Justice sought to construe the words of the agreement that provided for compression pressure between the buyer and seller, which "obligate[d] Lillis to pay for compression that Kachina 'install[ed] . . . to effect delivery.'" Essentially, it would be difficult, if not improbable, to conclude that Kachina could collect and deliver Lillis's gas without the compression it installed prior to the agreement and that which was installed to accommodate the high-pressure delivery requirements of Davis. Also, multiple people testified that the gas could not be delivered without the installed compression. Kachina's president said the compression was "necessary" to effect delivery, Lillis's counsel at oral argument agreed that the gas could not enter Kachina's pipeline if compression were turned off, and Lillis himself testified that he knew he would pay the compression costs. The Court rightfully determined that Lillis's testimonial expectations about the agreement do not define the provisions contained therein, but Kachina's compression effectuated delivery of the gas. It is customary, and acknowledged, that, under those circumstances, producers and buyers share the burden of compression costs.

The Chief Justice dissented against the holding of the Court that Kachina wrongfully deducted compression costs from Lillis's proceeds. On the other hand, the Chief Justice agreed with the Court that Kachina's right of first refusal did not create another five-year term under the agreement.