Supreme Court of Texas
March 21, 2014

FPL Energy v. TXU Portfolio Mgmt. Co.
No. 11-0050
Case summary by Caleb Segrest, Staff Member.

Justice GREEN delivered the opinion of the Court.

This case involved a contract dispute. Originally, subsidiary companies of FPL Energy (FPL) contracted with TXU Electric. Later, TXU Electric assigned its rights under the contract to TXU Portfolio Management Company (TXUPM). Essentially, FPL, as a producer of electric energy, agreed to provide TXU Electric with a certain amount of electricity and renewable energy credits (RECs) [Electric providers in Texas are required to meet a minimum requirement of renewable energy production. If they are unable to meet this requirement on their own, they may purchase and hold RECs in lieu of capacity from renewable energy technologies.] After production was limited due to grid congestion and subsequent curtailment of production ordered by the Electric Reliability Counsel of Texas, Inc. (ERCOT), TXUPM sued FPL on a claim that FPL breached the contracts by failing to produce the required electricity and RECs. FPL counterclaimed that TXUPM breached the contracts by failing to meet its responsibity under the contracts to ensure transmission capacity, which resulted in the shortages of energy production.

Issues: This case presented 3 primary issues: (1) Did TXUPM owe FPL a contractual duty to provide adequate transmission capacity to FPL; (2) if FPL breached and TXUPM did not, do the liquidated damages provisions in the contracts apply to energy *and* RECs or only to RECs; and (3) are the liquidated damages provisions in these contracts enforceable?

The trial court held that TXUPM was responsible for ensuring transmission capacity under the contracts and that liquidated damages under the contracts were enforceable. On appeal, the court of appeals reversed and held that TXUMP was not responsible for ensuring transmission capacity under the contracts and that the liquidated damages were enforceable because of the difficulty in estimating the damages. The Supreme Court of Texas *reversed* in part, holding that TXUPM did not breach the contracts because the contracts did not require TXUPM to provide transmission capacity for FPL but rather allocated risk of inadequate transmission capacity to FPL. The Court further held that FPL may owe damages for its breach of the contracts, but that the liquidated damages only applied to the RECs and are unenforceable as a penalty.

Regarding the first issue, the Court reached its conclusion that TXUPM was not responsible for transmission capacity for FPL based on an interpretation of the unambiguous terms of the contract. The contract provided that lack of transmission capacity was an uncontrollable force, thus TXUPM cannot be responsible. Further, section 4.05 of the contracts reinforced this point by making clear that FPL must

pay liquidated damages for failure to supply RECs *even if* the failure was the result of inadequate transmission capacity.

Regarding the second issue, the Court reached its conclusion that the liquidated damages clause only covered RECs and not energy generally based on the reasoning that other sections of the contracts provided for both RECs and energy, yet the liquidated damages provision provides no such reference. The Court notes that the lack of certain terms in a contract must be a deliberate choice of the parties, particularly in situations when the term is used elsewhere in the contracts.

Regarding the third issue, the Court held that the liquidated damages provision was not enforceable because it constituted a penalty. The basic principle underlying contract damages is compensation for losses sustained and no more; thus, courts will not enforce punitive contractual damages provisions. The Court acknowledged "two indispensable findings a court must make to enforce contractual damages provisions: (1) 'the harm caused by the breach is incapable or difficult of estimation,' and (2) 'the amount of liquidated damages called for is a reasonable forecast of just compensation.'" The Court found that the damages for RECs were difficult to estimate at the time of contracting due to the uncertainty of the market for RECs. However, the clause did did not meet the second prong of the test. Since the market value of RECs was incorporated into the liquidated damages calculation, the actual damages under the clause could range from $6,160,000 to $29,000,000. The Court called this an "unacceptable disparity." When there is an unbridgeable discrepancy between liquidated damages provisions as written and the unfortunate reality in application, courts cannot enforce such provisions. When the liquidated damages provisions operate with no rational relationship to actual damages, thus rendering the provisions unreasonable in light of actual damages, they are unenforceable. Because the liquidated damages provisions operated as a penalty, the Court held the provisions unenforceable.

Conclusion: "We hold that the contracts do not require TXUPM to provide transmission capacity to FPL, and thus TXUPM did not breach the contracts. FPL may owe damages for its breach, but the liquidated damages provisions in the contracts are unenforceable as a penalty. Accordingly, we reverse in part the judgment of the court of appeals and remand the case to the court of appeals to determine damages consistent with this opinion."

Gotham Ins. Co. v. Warren E&P, Inc.
No. 12-0452
Case Summary written by Jamie Vaughan, Staff Member.

Justice Guzman delivered the opinion of the Court.

Pedeco, Inc., Warren Resources, Inc. (WRI), and Oil Technology Fund (the Fund) entered into a joint operating agreement regarding the drilling of the Halff-Oppenheimer and other wells. The agreement provided Pedeco would be the operator and Pedeco and WRI would each get 12.5% of the working interest, while

the Fund would get the other 75% of the working interest. When Pedeco started drilling the well, the rig's blowout preventer failed and the well blew out. WRI reimbursed Pedeco for its operating expenses. Pedeco filed a claim with Gotham Insurance Company (Gotham), with whom it had a policy to cover its costs and working interests. Pedeco represented to Gotham that it owned 100% working interest in the well. After Gotham paid out claims totaling over $1.8 million, it discovered that lawsuits were pending against Pedeco by subcontractors alleging that Pedeco failed to use proper blowout equipment. Gotham also discovered that the operating agreement provided that Pedeco's interest was only 12.5%. Gotham then intervened in the subcontractors' lawsuits alleging breach of contract based on the blowout equipment and false representations of interest ownership. Gotham also added equitable claims for restitution and unjust enrichment. Pedeco filed a counterclaim against Gotham for not paying the claims under the policy.

The trial court entered summary judgment in favor of Pedeco, et al. The appellate court reversed, holding in favor of Gotham, holding that equitable relief was not barred because this was not a litigation settlement. That court also granted summary judgment in favor of Gotham on Pedeco's breach of contract claim, finding that Pedeco had not suffered a loss because WRI had reimbursed its operating expenses. The appellate court remanded the case for determination of damages, however, and on remand, the trial court awarded $1.8 million. On the second appeal, the court remanded again, and on remand, the trial court awarded $1.8 million again. The third appeal was transferred, and the new appellate court, considering new precedent, determined that Gotham was not entitled to equitable relief because the insurance policy addressed the issue and did not provide for such relief.

Issues:

(1) Can an insurance company's claim for equitable relief proceed when the policy covers the issues in dispute?

(2) Does the absence of a reimbursement clause in an insurance policy bar the insurance company's contract claims for reimbursement?

(3) Is a contract claim barred due to lack of loss where the party seeking relief has received reimbursement from a third party?

The court held that Gotham's claims in equity could not proceed because the insurance policy addressed the matters in dispute. Additionally, because there was evidence that Pedeco had breached its contract, the court held that Gotham's contract claims were not precluded. According to *Fortis Benefits v. Cantu*, where a policy addresses an issue in dispute, equitable relief is not available and recovery is limited to the party's contractual claims, unless such limitation violates law or public policy. The court agreed with Gotham that several clauses addressed the issue in dispute, including the due diligence, misrepresentation, salvage and recoveries, reporting, and subrogation clauses. Additionally, the court found that the contract did not violate public policy because it reflected state laws found in

both the Texas Insurance Code and the Texas Railroad Commission's rules. Turning to Gotham's contract claims, the court first held that Gotham had not waived the claim and that the absence of a reimbursement clause in the contract did not bar the claims because there was breach, causation, and damages. Finally, the court held, contrary to the trial court's holding, that there was a genuine issue of fact that Pedeco had suffered damages even though WRI reimbursed it for its expenses in controlling the well. Therefore, Gotham was not subject to summary judgment on Pedeco's cross-claims for breach of contract. The court remanded the case for further consideration on the contract claims.