

Tulsa Law Review

Volume 27 | Issue 2

Winter 1991

The Take-or-Pay Wars: A Cautionary Analysis for the Future

J. Michael Medina

Follow this and additional works at: <https://digitalcommons.law.utulsa.edu/tlr>



Part of the [Law Commons](#)

Recommended Citation

J. M. Medina, *The Take-or-Pay Wars: A Cautionary Analysis for the Future*, 27 Tulsa L. J. 283 (2013).

Available at: <https://digitalcommons.law.utulsa.edu/tlr/vol27/iss2/7>

This Article is brought to you for free and open access by TU Law Digital Commons. It has been accepted for inclusion in Tulsa Law Review by an authorized editor of TU Law Digital Commons. For more information, please contact megan-donald@utulsa.edu.

ESSAY

THE TAKE-OR-PAY WARS: A CAUTIONARY ANALYSIS FOR THE FUTURE*

J. Michael Medina† ‡

“Those who cannot remember the past are condemned to repeat it.”¹

“Experience enables you to recognize a mistake when you make it again.”²

I. INTRODUCTION

The first generation of take-or-pay battles—those between the natural gas producers and pipeline companies (“pipelines”)—is subsiding.³

* Copyright © 1991 by J. Michael Medina. A modified version of this paper was presented to the Special Institute on Natural Gas Marketing and Transportation conducted by the Rocky Mountain Mineral Law Foundation, September 20, 1991, in Santa Fe, New Mexico.

† B.A. summa cum laude, Southwestern College, Winfield, Kansas; J.D. with special distinction, 1975, University of Oklahoma. Adjunct Professor of Law, 1992, University of Tulsa, College of Law, Tulsa, Oklahoma. Member, Holliman, Langholz, Runnels & Dorwart, P.C., Tulsa, Oklahoma. Mr. Medina currently represents only producers in gas contract litigation.

‡ The contract provisions throughout this paper are intended only to stimulate discussion and analysis.

1. 1 GEORGE SANTAYANA, *THE LIFE OF REASON* 284 (2d ed. 1922).

2. LAURENCE J. PETER, *PETER'S QUOTATIONS* 174 (1979) (quoting Franklin P. Jones).

3. This paper will avoid extensive citations and will, for the most part, not cite authorities discussed in earlier articles. For those interested in more extensive citations on gas contract litigation than those listed in this paper, see J. Michael Medina, *Take-or-Pay Oklahoma Style*, 60 OKLA. B.J. 705 (1989); J. Michael Medina, *The Take-or-Pay Wars: A Further Status Report*, 41 OKLA. L. REV. 381 (1988) [hereinafter Medina, *A Further Status Report*]; J. Michael Medina, *A Report from the Battle Zone: The Take or Pay Wars*, 58 OKLA. B.J. 2554 (1987) [hereinafter Medina, *A Report from the Battle Zone*], reprinted in 24 PUB. LAND & RESOURCES L. DIG. 268 (1987); and J. Michael Medina et al., *Take or Litigate: Enforcing the Plain Meaning of the Take-or-Pay Clause in Natural Gas Contracts*, 40 ARK. L. REV. 185 (1986) [hereinafter Medina et al., *Take or Litigate*], reprinted in 24 PUB. LAND & RESOURCES L. DIG. 192 (1987). An extensive bibliography of materials on take-or-pay contracts and litigation can be found in 8 HOWARD R. WILLIAMS & CHARLES J. MEYERS, *OIL AND GAS LAW, MANUAL OF OIL AND GAS TERMS* 1233-44 (1991).

While major pieces of producer-pipeline litigation remain in the courts,⁴ attention has now turned to two new fronts: producer-lessor royalty disputes⁵ and state severance tax controversies.⁶ At this junction, it is appropriate to look at past take-or-pay disputes and extract lessons to guide future gas purchase contracting. Past litigation shows that courts will not grant relief simply because a party enters into a bad bargain.⁷ There

4. See *Columbia Gas Transmission Corp. v. Koch Indus.*, No. 91-174 (E.D. La. April 22, 1991) (holding "banked gas" of underproduced party covered by take-or-pay obligations); *Pelto Oil Co. v. CSX Oil & Gas Corp.*, 804 S.W.2d 583 (Tex. App.—Houston [1st Dist.] 1991, writ denied). For an analysis of various gas balancing problems, see Wade A. Hoefling, *Gas Balancing Problems in a Deregulated Market: Changes and Possible Solutions Under Oklahoma Law*, 25 TULSA L.J. 63 (1989); and Patrick H. Martin, *The Gas Balancing Agreement: What, When, Why, and How*, 36 ROCKY MOUNTAIN L. INST. § 13.01 (1990). For an analysis of disproportionate gas sales by a working interest owner and its relation to gas balancing, see David E. Pierce, *The Law of Disproportionate Gas Sales*, 26 TULSA L.J. 135 (1990).

5. See, e.g., *Diamond Shamrock Exploration Co. v. Hodel*, 853 F.2d 1159 (5th Cir. 1988); *Frey v. Amoco Prod. Co.*, 708 F. Supp. 783 (E.D. La. 1989), *rev'd*, 943 F.2d 578 (5th Cir. 1991); *Mandell v. Hamman Oil & Ref. Co.*, No. 01-90-00950-CV, 1991 WL 248676 (Tex. App.—Houston [1st Dist.] Nov. 27, 1991, no writ); *Killam Oil Co. v. Bruni*, 806 S.W.2d 264 (Tex. App.—San Antonio 1991, writ denied); *Hamman Oil & Ref. Co. v. Mandell*, No. 87-41636 (Tex. Dist. Ct. Harris County June 22, 1990); *State v. Pennzoil Co.*, 752 P.2d 975 (Wyo. 1988); cf. Finkelstein v. Transamerican Natural Gas Corp. (*In re Transamerican Natural Gas Corp.*), 127 B.R. 800 (S.D. Tex. 1991) (remanding to state court a dispute over a take-or-pay settlement). For recent discussions on the issue of royalties, see Cyril A. Fox, jr., *Rights of a Lessor in Payments Received by a Producer from "Buydowns" or "Buyouts" of Long-Term Contracts*, 10 E. MINN. L. INST. § 1.01 (1989); William H. White, *The Right to Recover Royalties on Natural Gas Take-or-Pay Settlements*, 41 OKLA. L. REV. 663 (1988); Kirk J. Bily, Comment, *Royalty on Take-or-Pay Payments and Related Consideration Accruing to Producers*, 27 HOUS. L. REV. 105 (1990); and James E. Prince, Note, *Production, Production, What is Production?* *Diamond Shamrock v. Hodel*, 1989 B.Y.U. L. REV. 1333.

6. See Elizabeth K. Brown & Frank H. McGregor, *Fallout from the Take-or-Pay Wars: Gross Production Tax on Proceeds Received in Settlement of Take-or-Pay Litigation*, 43 OKLA. L. REV. 457 (1990); Michael P. Pearson & Richard D. Watt, *To Share or Not to Share: Royalty Obligations Arising out of Take-or-Pay or Similar Gas Contract Litigation*, 42 INST. ON OIL & GAS L. & TAX'N ¶ 14.01, ¶ 14.03[2][c][iii] (1991); cf. John S. Lowe, *Severance Taxes as an Issue of Energy Sectionalism*, 5 ENERGY L.J. 357 (1984).

7. Courts have consistently refused to save a party from a bad bargain. See, e.g., *United States v. Bethlehem Steel Corp.*, 315 U.S. 289, 301 (1942) (holding coercion was not established even though government lacked bargaining strength because of its great need for warships); *Aircraft Assocs. & Mfg. Co. v. United States*, 357 F.2d 373, 378 (Ct. Cl. 1966) ("Economic duress may not be implied merely from the making of a hard bargain."); *Fruhauf Southwest Garment Co. v. United States*, 111 F. Supp. 945, 951 (Ct. Cl. 1953) ("In order to substantiate the allegation of economic duress . . . the plaintiff must go beyond the mere showing of a reluctance to accept and of financial embarrassment."); *LaBeach v. Beatrice Foods Co.*, 461 F. Supp. 152 (S.D.N.Y. 1978) (holding economic duress did not vitiate release of monetary claims by discharged employee despite disparity of bargaining power); *W.J. Seufert Land Co. v. Greenfield*, 496 P.2d 197, 201 (Or. 1972) (holding contract provision that was harsh on one party and not the other was not against public policy); *Horgan v. Industrial Design Corp.*, 657 P.2d 751, 754 (Utah 1982) (holding that a bad bargain is not a basis on which to invalidate an agreement).

Judicial unwillingness to interfere with a bad bargain is demonstrated by almost universal rejection of the pipeline defenses of unconscionability, impracticability, public policy, and mistake. In a similar vein, courts seldom invalidate settlement agreements. E.g., *Bryant v. Transcontinental Gas Pipe Line Corp.*, No. B14-90-00590-CV, 1991 WL 114477 (Tex. App.—Houston [14th Dist.] June 27, 1991, writ requested) (affirming order that enforced settlement agreements against producers);

is no indication that this basic precept will change for future litigants. To date, producers have prevailed in most take-or-pay disputes⁸ because the pipelines, who drafted most purchase contracts, failed to protect themselves, and not because of superior producer draftsmanship. The future may not be so kind to the producers.

This paper first summarizes past producer-pipeline litigation wars. Second, the successes and failures of battle strategies of both producers and pipelines are examined. Finally, based upon the lessons learned from past disputes, the paper analyzes specific clauses in gas purchase contracts. The most important lesson learned from past take-or-pay disputes is that courts will strictly enforce the terms of a gas purchase contract.⁹ Consequently, success in the future generations of take-or-pay wars will depend upon carefully drafted contracts.

see J. Michael Medina, *Economic Duress as a Means of Avoiding Settlement Agreements in Oklahoma*, 15 OKLA. CITY U. L. REV. 255 (1990). Given their widely recognized validity, settlement agreements must be carefully drafted. See Medina et al., *Take or Litigate*, supra note 3, at 253-55, reprinted in 24 PUB. LAND & RESOURCES L. DIG. at 260-62.

8. Tennessee Gas Pipeline Co., 54 F.E.R.C. ¶ 61,095 (1991).

9. See David E. Pierce, *Developments in Nonregulatory Oil and Gas Law: Relationships, Contracts, Torts, and the Basics*, 41 INST. ON OIL & GAS L. & TAX'N § 1.01, § 1.03[2] (1990) ("[I]t is not surprising to find language, conceived during another contracting era, which attempts to address the parties' rights under weak market conditions. Although such language may not have been the focus of negotiations leading to the contract, it is, nevertheless, equally enforceable."). This literal approach worked mostly in the past to benefit producers. E.g., *Wagner & Brown II v. ONEOK, Inc.*, No. CIV-89-943-R (W.D. Okla. Mar. 29, 1990) (striking force majeure because pipeline sent notice to operator, not seller as required by the contract); *R.J.B. Gas Pipeline Co. v. Colorado Interstate Gas Co.*, 813 P.2d 14, 24-25 (Okla. Ct. App. 1990) (strictly construing recoupment provisions and disallowing the pipeline to offset breach of contract damages with the value of unrecouped gas). Moreover, courts refused to allow pipeline companies to stand behind standard gas contract provisions for protection against events not originally contemplated by the provisions. See, e.g., *Mustang Prod. Co. v. Delhi Gas Pipeline Co.*, No. CIV-83-1667-BT, slip op. at 9-10 (W.D. Okla. Nov. 9, 1983) (holding that economic disconnect clause was intended to permit a pipeline to disconnect gas wells that are uneconomical due to low production, not low market prices); cf. *Coastal Oil & Gas Corp. v. FERC*, 782 F.2d 1249, 1253 (5th Cir. 1986) (holding economic connection clause does not limit dedication to interstate commerce; "Coastal's internal memoranda indicate that this interpretation was a new theory dreamed up by its counsel as recently as 1980").

Producers also lost cases because of the courts' insistence on strict performance of contract terms. See, e.g., *Dyco Petroleum Corp. v. ANR Pipeline Co.*, No. 86-C-1097-C (N.D. Okla. Oct. 27, 1989) (denying producer's claims because it failed to provide notice of drainage damage to the pipeline company as required by the contract); *Prima Energy Corp. v. Panhandle E. Pipe Line Co.*, No. 89-CV-331 (Colo. Dist. Ct. Weld County Oct. 5, 1990) (enforcing assignment notice clause); *Williams Natural Gas Co. v. Amoco Prod. Co.*, No. 11040, 1991 WL 58387 (Del. Ch. Apr. 16, 1991) (enforcing ratable take clause to relieve pipeline of take-or-pay obligation when pipeline's loss of other contracts in area caused it to take no gas from the seller); *Lone Star Gas Co. v. G.S.G. Royalty Corp.*, 757 S.W.2d 457, 459-60 (Tex. App.—Dallas 1988, no writ) (construing "deemed produced" clause strictly in favor of pipeline); *Lone Star Gas Co. v. Lively Energy & Dev. Corp.*, No. 04-87-00261-CV, slip op. at 3-11 (Tex. App.—San Antonio Oct. 11, 1989, no writ) (reversing lower court award in favor of producer because pipeline's take-or-pay clause obligation was conditioned on ownership and producer did not have an ownership interest).

II. EVOLUTION OF THE NATURAL GAS CONTRACT

Prior to 1960, fluctuations in the demand for natural gas created financial hardships for natural gas producers. The demand for natural gas increases substantially during winter months because natural gas is used for commercial and residential heating. To handle winter peaks, pipelines acquired an overabundance of production capacity from producers. In addition, pipelines insisted that producers exclusively dedicate particular wells or reservoirs to the pipeline in the gas purchase contract. Pipelines, however, were under no obligation to purchase gas from the producers. As a result, during periods of low demand for natural gas pipelines purchased less than full production from producers, if any gas at all. Producers, unable to sell the gas to other purchasers because of the exclusive dedication clause, suffered from lost gas sales revenue. In many cases, producers were unable to recover drilling, exploration and operation costs.

Producers sought refuge in the take-or-pay clause. The provision required the pipeline to purchase a minimum quantity of gas each period, regardless of whether the pipeline took the minimum quantity of gas. In the event the pipeline paid for more gas than it took, it acquired the right to take that gas in the future at no cost. The take-or-pay clause assured the producer of continued revenue, regardless of the market demand for gas.

Historically, the pipeline industry was rather cavalier toward the take-or-pay clause. During the 1970s and early 1980s, pipelines routinely included the clause in natural gas contracts. Such clauses were insignificant to the pipeline when considered in the overall context of the contract because demand for natural gas had historically exceeded the supply.

The producer was not as ambivalent toward inclusion of a take-or-pay clause in the gas purchase contract. The producer always regarded the take-or-pay clause as a necessity because a gas well is worthless if no gas is sold.¹⁰

Take-or-pay clauses, however, are more than just bargaining chips in negotiations for new gas reserves. They provide reasonable assurance to the producer of a certain minimum income stream from a well in cases where the producer is asked to make a long-term commitment of

10. Richard J. Pierce, *Reconsidering the Roles of Regulation and Competition in the Natural Gas Industry*, 97 HARV. L. REV. 345, 354-55 (1983); Vernon M. Turner, *Natural Gas—Impact of Deregulation or Reregulation on Sales Contracts*, 29 ROCKY MTN. MIN. L. INST. 501, 522-23 (1983).

its gas to a single buyer. Having dedicated its gas under such a contract, it is of critical importance to the producer to have some assurance of recovering its substantial investment in the wells involved. Indeed, without a guaranteed minimum cash flow, producers are usually unwilling to commit their reserves to a single purchaser on a long-term basis.¹¹

By 1970, take-or-pay clauses became a standard part of the natural gas contract; producers absolutely required the clause, and pipelines acquiesced because of the demand for natural gas.¹²

During the 1980s, falling natural gas prices caused pipelines to regret inclusion of the take-or-pay clause in long-term natural gas contracts. After the decline, the market price for gas was substantially less than the fixed price in the contract in most instances. The price discrepancy forced pipelines to choose between taking gas at the contract price and reselling at the lower market price or paying for gas and taking it later, with the hope that the market price would increase in the future. As gas prices stabilized at less than long-term contract prices, pipelines realized that performance under the old contracts would be unprofitable.¹³ As a result, many pipelines attempted to minimize their liability through negotiation and modification of the contracts, settlements and litigation. These endeavors, however, resulted in little success for the pipelines.

11. El Paso Natural Gas Co., 40 F.E.R.C. ¶ 63,047 (1987), *aff'd*, 42 F.E.R.C. ¶ 61,024 (1988); see also Susan Zachos, Comment, *Gas Purchase Contracts: Equitable Remedies for Breach*, 24 HOUS. L. REV. 991, 993-95 (1987); Order No. 500-K, Natural Gas Pipelines After Partial Wellhead Decentralization, et al., III F.E.R.C. Stats. & Regs. ¶ 30,917, at 30,090 (Apr. 4, 1991) ("The whole purpose of the take-or-pay clause was to ensure the producer a minimum level of income by requiring the pipeline either to purchase and pay for the gas or, if it did not purchase the gas, at least pay for it."); cf. Williston Basin Interstate Pipeline Co. v. FERC, 931 F.2d 948 (D.C. Cir. 1991) (producer's leverage with pipeline diminishes as field diminishes).

12. Significant bargaining, however, continued in the industry. See Harry G. Broadman, *Elements of Market Power in the Natural Gas Pipeline Industry*, ENERGY J., Jan. 1986, at 119; William B. Cassin, *Gas Purchase Contracts—Enticing a Shy Genie from an Invisible Lamp*, 25 INST. ON OIL & GAS L. & TAX'N 27, 30-31 (1974); J. Harold Mulherin, *Complexity in Long-Term Contracts: An Analysis of Natural Gas Contractual Provisions*, 2 J.L. ECON. & ORGAN. 105 (1986); see also Scott E. Masten & Keith J. Crocker, *Efficient Adaptation in Long-Term Contracts: Take-or-Pay Provisions for Natural Gas*, 75 AM. ECON. REV. 1083 (1985).

13. Pipelines bear the risk of a decreasing market price in a long-term gas contract. *E.g.*, Prenalta Corp. v. Colorado Interstate Gas Co., 944 F.2d 677, 680, 688 (10th Cir. 1991); Universal Resources Corp. v. Panhandle E. Pipe Line Co., 813 F.2d 77, 80 (5th Cir. 1987); United States v. Panhandle E. Corp., 693 F. Supp. 88, 98 (D. Del. 1988), *aff'd*, 868 F.2d 1363 (3d Cir. 1989); *R.J.B. Gas Pipeline Co.*, 813 P.2d at 25 ("[T]ake-or-pay provisions . . . are deemed to [allocate] the risks [and] must be strictly construed."); Valero Transmission Co. v. Mitchell Energy Corp., 743 S.W.2d 658, 663 (Tex. App.—Houston [1st Dist.] 1987, no writ) ("[T]he uncertainty of future market prices is often the motivation for entering into a long-term contract. The primary purpose of a price agreement is to fix the price and consequently avoid the risk of price fluctuation.").

Despite pipelines' harsh experiences, the long-term contract remains an important part of the natural gas industry. Although producers and pipelines have experimented with other arrangements,¹⁴ long-term contracts remain mutually beneficial for both parties.¹⁵

III. THE TAKE-OR-PAY CLAUSE

A typical take-or-pay clause specifies an annual minimum quantity of gas for which the producer will be compensated. The minimum quantity is typically a fraction of either the deliverability of the gas well or the underground gas reserves dedicated to the contract.¹⁶ In the event the purchaser fails to take the minimum annual quantity, the purchaser must pay a "deficiency payment." This payment is equivalent to the value of

14. With the gas surplus of 1982 came a radical shift in the natural gas industry. Short-term ("spot market") contracts emerged as the standard industry practice. In contrast with previous long-term contracts, newer long-term contracts contained a "take-or-release" in lieu of a take-or-pay clause. A take-or-release clause is one "which gives the seller the right to terminate the contract if the buyer does not take minimum amounts of gas." WILLIAMS & MEYERS, *supra* note 3, at 1246.

15. With deregulation and the shifting roles of pipelines, new opportunities for contracting arise. However, the same desire for market stability that led to long-term contracts in the first place will continue to encourage long-term contracts in the future. Equitrans, Inc., 52 F.E.R.C. ¶ 61,228, at 61,814-15 (1990) (discussing need to provide incentives functionally similar to take-or-pay clauses to induce producers to restructure relationship with purchasers, and noting need of producers to have revenue certainty); R. Glenn Hubbard & Robert J. Weiner, *Efficient Contracting and Market Power: Evidence from the U.S. Natural Gas Industry*, 34 J.L. ECON. 25, 64-65 (1991) (predicting that economics and market efficiency will lead to reemergence of long-term contracting).

For an analysis of the benefits of long-term contracting, see Harry C. Broadman & Michael A. Toman, *Non-Price Provisions in Long Term Natural Gas Contracts*, 62 LAND ECON. 111 (1986); Michael E. Canes & Donald A. Norman, *Long-Term Contracts and Market Forces in the Natural Gas Market*, 10 J. ENERGY & DEV. 73 (1984); Thomas G. Johnson, *Natural Gas Sales Contracts*, 34 INST. ON OIL & GAS L. & TAX'N 83, 108-09 (1983); Norris C. McGowen, *Natural Gas—Its Present and Future*, 4 INST. ON OIL & GAS L. & TAX'N 133, 142 (1953); Ernst-Joachim Mestmäcker, *Natural Gas in the European Internal Market: A Comparative Analysis of Common Carriage and Price Transparency*, 11 MICH. J. INT'L L. 691 (1990); Pierce, *supra* note 10, at 356-57, 383-84.

For recent articles on natural gas contracts, see 4 W.L. SUMMERS, *THE LAW OF OIL AND GAS* § 762 (Supp. 1991); Joe Caggiano, *Understanding Natural Gas Contracts*, 38 OIL & GAS TAX. Q. 267 (1989); William H. Penniman & Gail S. Gilman, *Negotiating a Direct Gas Purchase Contract for the End User*, 10 E. MIN. L. INST. § 17.01 (1989); Carroll L. Gilliam, *Gas Sales Contracts in a Changing Market*, 37 INST. ON OIL & GAS L. & TAX'N § 6.01 (1986); J. Clayton La Grone, *The Supply Side of Cogeneration*, 36 ROCKY MTN. MIN. L. INST. § 14.01 (1990); John S. Lowe, *A New Generation of Gas Contracts*, 8 CORP. COUNSEL REV. 1 (1989); Masten & Crocker, *supra* note 12; Arthur J. Wright, *Contractual Issues in Marketing Natural Gas in the 1990's*, 36 ROCKY MTN. MIN. L. INST. § 16.01 (1990); Danton B. Rice & Michael A. Schlueter, Note, *Deregulation and Natural Gas Purchase Contracts: Examination Through Neoclassical and Relational Contract Theories*, 25 WASHBURN L.J. 43, 46-49 (1985). See also *Apache Gas Prods. Corp. v. Oklahoma Tax Comm'n*, 509 P.2d 109, 112-13 (Okla. 1973) (recognizing necessity for long-term contracts in natural gas industry).

16. For example, a minimum quantity could be "seventy-five percent (75%) of the Delivery Capacity of each well." See Medina et al., *Take or Litigate*, *supra* note 3, at 187, reprinted in 24 PUB. LAND & RESOURCES L. DIG. at 194. For a recent discussion of the take-or-pay clause, see *Prenalta Corp. v. Colorado Interstate Gas Co.*, 944 F.2d 677, 679-81 (10th Cir. 1991).

the difference between the minimum annual quantity and the amount taken during the year.

Another traditional term in the contract between producer and pipeline is the recoupment provision. The recoupment provision of the take-or-pay clause allows the buyer to take, without payment, a quantity of gas valued at the amount of the deficiency payments paid in previous periods. Three concepts govern recoupment. First, a buyer may recoup only after taking the minimum quantity for the current year.¹⁷ Second, the recoupment quantity is determined by the contract price of the gas at the time of recoupment. Third, the buyer's right to recoup may be limited in time by law or contract. In the event the buyer does not recoup within the time limit, the buyer forfeits the right to recoup and the seller is allowed to keep the deficiency payments. Some contracts allow the buyer to recoup during the life of the contract. Others require the seller to return any outstanding deficiency payments at the end of the contract.

IV. PRODUCER'S HISTORICAL REMEDIES

The producer's primary remedy to enforce its rights under the contract was a suit to collect past due deficiency payments. Typically, damages equaled the value of the difference between the minimum quantity and the quantity taken. For example, if the pipeline was required to purchase 750,000 cubic feet ("cf") of natural gas per year and only purchased 50,000 cf, the pipeline's deficiency would be 700,000 cf. At a contract price of \$3.00 per 1000 cf, the pipeline would owe the producer a deficiency payment of \$2,100 for that accounting year.

Pipelines have disputed this method of calculating damages, citing UCC remedy provisions. Section 2-708(1) provides a "measure of damages for non-acceptance or repudiation by the buyer [equal to the] difference between the market price at the time and place for tender and the unpaid contract price together with . . . incidental damages."¹⁸ Pipelines argued that under the section 2-708(1) damage formula producers are required to deduct the market price of the gas at the time of breach from the contract price.¹⁹

17. *E.g.*, *Sid Richardson Carbon & Gasoline Co. v. InterNorth, Inc.* 595 F. Supp. 497, 500 (N.D. Tex. 1984).

18. U.C.C. § 2-708(1), 1B U.L.A. 265 (1989).

19. Gas purchase contracts are governed by Article 2 of the Uniform Commercial Code. *See Manchester Pipeline Corp. v. Peoples Natural Gas Co.*, 862 F.2d 1439, 1444-46 (10th Cir. 1988) (applying Oklahoma's version of UCC remedies to breach of gas contract); *Kerr-McGee Corp. v. Northern Utils., Inc.*, 673 F.2d 323, 328-30 (10th Cir.) (applying UCC unconscionability provision to gas contract), *cert. denied*, 459 U.S. 989 (1982); *Pennzoil Co. v. FERC*, 645 F.2d 360, 388 (5th

Producers countered with numerous arguments to show that the application of section 2-708(1) to take-or-pay disputes yields inequitable results. First, based on the section 2-708(1) formula, the producer would be unable to receive damages if, at the time of breach, the market price exceeded the contract price.²⁰ In such a market, a pipeline's threat of

Cir. 1981) (applying UCC writing requirement to gas contract), *cert. denied*, 454 U.S. 1142 (1982); J. Thomas Hardin, *Applicability of Article 2 of the Uniform Commercial Code to Oil and Gas Contracts*, 23 ARK. LAW. 57 (1989); William J. Legg & Joseph R. Dancy, *The Applicability of the Uniform Commercial Code to Natural Gas Contracts*, 36 OIL & GAS TAX. Q. 67 (1987); L.M. McCorkle, Jr. & Thomas O. Ruby, *Contracts for the Sale of Gas—A Uniform Commercial Code Analysis*, 7 E. MIN. L. INST. § 15.01 (1986); Theodore M. Smith, *How the Uniform Commercial Code Applies to Natural Resources Transactions*, 33 ROCKY MTN. MIN. L. INST. § 5.01 (1988).

Producers argue that pursuant to UCC §§ 2-719(1)(a) and 1-102(3), the contracting parties intended to include an alternate damage remedy equivalent to the volume deficiency times the contract price, in substitution of an otherwise applicable UCC damage provision. *Prenalta Corp. v. Colorado Interstate Gas Co.*, 944 F.2d 677, 687-90 (10th Cir. 1991) (rejecting UCC measure of damages in take-or-pay case). This issue is currently before the Oklahoma Supreme Court. *Forest Oil Corp. v. ONEOK, Inc.*, No. 71,582 (Okla. filed Aug. 24, 1988). The UCC embodies a strong policy of freedom of contract, especially between merchants. *Louisiana Nev. Transit Co. v. Marathon Oil Co.*, 770 F. Supp. 325 (W.D. La. 1991) (enforcing the producer's contractual remedy of canceling the contract upon buyer's failure to take or pay); *Frank Le Roux, Inc. v. Burns*, 480 P.2d 213 (Wash. Ct. App. 1971) (holding that a contract may contain remedies in addition to those in the UCC, provided alternative remedies are not unconscionable or commercially unreasonable); 1 JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE, PRACTITIONER'S EDITION § 3-2 (3d ed. 1988 & Supp. 1991); Charles Bunn, *Freedom of Contract Under the Uniform Commercial Code*, 2 B.C. INDUS. & COM. L. REV. 59 (1960).

20. See *Prenalta Corp.*, 944 F.2d at 690-91 (holding that § 2-708(1) did not provide an adequate remedy when the market price exceeded the contract price in a take-and-pay case and therefore § 2-708(2) was appropriate). See generally Robert Childres & Robert K. Burgess, *Seller's Remedies: The Primacy of UCC 2-708(2)*, 48 N.Y.U. L. REV. 833 (1973) (discussing seller's lost profit remedy under § 2-708(2)); Charles J. Goetz & Robert E. Scott, *Measuring Sellers' Damages: The Lost-Profits Puzzle*, 31 STAN. L. REV. 323 (1979) (determining when compensation requires the award of lost volume profits); Richard E. Speidel & Kendall O. Clay, *Seller's Recovery of Overhead Under UCC Section 2-708(2): Economic Cost Theory and Contract Remedial Policy*, 57 CORNELL L. REV. 681 (1972) (discussing policy considerations behind § 2-708(2)).

Theoretically, the producer could sue under § 2-708(2) as a "lost volume" seller and seek to recover his lost profits. See 4 RONALD A. ANDERSON, UNIFORM COMMERCIAL CODE § 2-708:21 to :29 (3d ed. 1983 & Supp. 1990) (generally discussing lost volume sellers); 3 WILLIAM D. HAWKLAND, UNIFORM COMMERCIAL CODE SERIES § 2-708:04 (1984 & Supp. 1991) (illustrating lost volume seller damage calculation).

The complexity of applying § 2-708(2) to an alternative performance contract such as a take-or-pay agreement has not been explored. Should the "pay" alternative be employed, § 2-708(2) yields a result comparable to the contract remedy of contract price times the deficiency amount. See *Colorado Interstate Gas Co. v. Natural Gas Pipeline Co. of Am.*, 661 F. Supp. 1448, 1477-78 (D. Wyo. 1987) (holding § 2-708(2) was an appropriate measure of damages where no market for the gas existed as a result of the buyer's refusal to transport the gas; buyer effectively precluded seller from selling to others), *aff'd in part, rev'd in part*, 885 F.2d 683 (10th Cir. 1989), *cert. denied*, 111 S. Ct. 441 (1990); *cf. Prenalta Corp.*, 944 F.2d at 690-91 (holding § 2-708(2) applicable to take-and-pay contracts).

Alternatively, a producer may seek an action for the price (deficiency payments) pursuant to § 2-709. Under this remedy, however, the pipeline would retain all contractual recoupment rights. See *Commonwealth Edison Co. v. Decker Coal Co.*, 653 F. Supp. 841, 843-45 (N.D. Ill. 1987) (rejecting application of § 2-708(2) to a coal contract containing provisions analogous to a take-or-pay clause, and awarding the seller the price under § 2-709(1) subject to buyer's rights to mine coal

breach could pressure producers to renegotiate the contract in favor of the pipeline. The producer, bound by its exclusive dedication, would be unable to sell to other parties, a remedy contemplated by the UCC.²¹ Second, the producers argued that the market price element of the section 2-708(1) formula was ambiguous. Was the market price the spot-market price or a fictional long-term contract price?²²

Additionally, producers argued that the use of section 2-708(1) would give the pipeline an unlimited right of recoupment, a right not contemplated by the parties.²³ Typically, pipelines must recoup gas within five years of the deficiency payment. Damages under section 2-708(1) would grant the pipelines an unlimited recoupment and defeat the

in the future). See generally 4 ANDERSON, *supra* note 20, § 2-709; 3 HAWKLAND, *supra* note 20, § 2-709; John S. Herbrand, Annotation, *Seller's Recovery of Price of Goods from Buyer Under UCC § 2-709*, 90 A.L.R.3d 1141 (1979 & Supp. 1991). The Oklahoma Supreme Court, however, strictly construes the price remedy and limits its application to the specific instances enumerated in § 2-709. *French v. Sotheby & Co.*, 470 P.2d 318, 322-23 (Okla. 1970).

21. U.C.C. § 2-706. See generally, 4 ANDERSON, *supra* note 20, § 2-706; 3 HAWKLAND, *supra* note 20, § 2-706; Roy R. Anderson, *Plunging the Depths of the Seller's Resale Remedy Under the Uniform Commercial Code*, 50 J. AIR L. & COM. 411 (1985). In *Sabine Corp. v. ONG W., Inc.*, 725 F. Supp. 1157, 1186-87 (W.D. Okla. 1989), the court discussed in passing the resale remedy in the context of a take-or-pay contract. However, it did not reach the issue of whether a producer must mitigate damages by attempting to sell gas to third parties in contravention of an exclusive dedication clause.

22. In *Manchester Pipeline Corp.*, 862 F.2d at 1446-48, the court found that the appropriate damages for buyer's breach of a long-term gas contract was the contract price less the market price of a similar long-term contract determined at the time the seller learned of buyer's repudiation. *Id.* at 1448. The court rejected a damage calculation based on the spot market price. *Id.* Application of the court's damage formula is impractical because a freely negotiated, comparable contract rarely exists. See 4 SUMMERS, *supra* note 15, § 762 (discussing new forms of gas contracts); cf. *Pierce*, *supra* note 9, § 1.03[1][d] (positing that *Manchester* assumes the producer would be able to obtain a higher price for gas committed under a long-term contract than the spot market price). *But cf.* 1 WHITE & SUMMERS, *supra* note 19, § 7-18, at 34 (Supp. 1991) (approving *Manchester*, but not discussing the problem of finding a similar long-term contract).

In some instances, the long-term contract price may be less than the spot market price, given the relative current bargaining strengths of the parties. Therefore, the spot market price is likely a more reliable indicator than a fictitious "equivalent" long-term contract. *Manchester* should be limited to cases where damages for anticipatory repudiation are sought under § 2-610. Moreover, the existence of a market-out clause further distinguished *Manchester* from a typical take-or-pay case. See *Manchester Pipeline Corp.*, 862 F.2d at 1441 n.1, 1443-49. The question of what is the proper measure of damages for anticipatory repudiation of a take-or-pay contract has been certified to the Oklahoma Supreme Court. See *Roye Realty & Developing, Inc. v. Arkla, Inc.*, No. CIV-89-993-R (W.D. Okla. May 17, 1991) (order certifying a question of state law).

23. Courts have consistently rejected the argument that the pipeline's inability to profitably exercise recoupment rights justifies judicial relief on their behalf. See, e.g., *Universal Resources Corp. v. Panhandle E. Pipe Line Co.*, 813 F.2d 77 (rejecting argument that the pipeline's breach was justified because the producer did not have enough gas production over and above contract volume to satisfy deficiency), *reh'g denied*, 821 F.2d 1097 (5th Cir. 1987); *Sabine Corp.*, 725 F. Supp. at 1172-84 (holding pipeline was obligated to take or pay for gas even though the market price severely declined since execution of the contract); *Sid Richardson Carbon & Gasoline Co. v. InterNorth, Inc.*, 595 F. Supp. 497, 500-01 (N.D. Tex. 1984) (holding that public policy against planned breach of contract mandated enforcement of take-or-pay clause).

producers' expectation and the parties' contemplation that the pipelines may pay twice for the same gas.²⁴ Finally, producers contended that take-or-pay contracts were peculiar to the natural gas industry and did not easily fit within the parameters of section 2-708(1).²⁵

In addition to actions for past due deficiency payments, producers sought to increase their recovery. For example, producers attempted to recover interest on past due deficiency payments. However, recovery normally consisted of interest provided by statute,²⁶ if any, because natural gas contracts rarely provided for interest on past due payments. Because the pipeline often obtained an interest rate higher than the

24. See *Universal Resources Corp.*, 813 F.2d at 80 ("The definition of makeup gas contemplates . . . that the buyer may never receive gas for which he has already paid."); *Lone Star Gas Co. v. McCarthy*, 605 S.W.2d 653, 656-57 (Tex. App.—Houston [1st Dist.] 1980, writ ref'd n.r.e.) ("[U]nder the normal take or pay clause, the buyer takes a risk that it might not be able to make up a deficiency within the make-up period. Thus, if the gas is not made-up, then the buyer effectively purchases the gas a second time."). In effect, a recoupment period reflects the parties' allocation of the risks. *Hanover Petroleum Corp. v. Tenneco Inc.*, 521 So. 2d 1234, 1241 (La. Ct. App.) (holding that take-or-pay provision resulted from the parties' bargaining over allocation of risks), *cert. denied*, 526 So. 2d 800 (La. 1988); *R.J.B. Gas Pipeline Co. v. Colorado Interstate Gas Co.*, 813 P.2d 14, 24 (Okla. Ct. App. 1990) ("[T]he parties to the contract are assumed to have allocated the risk in a take-or-pay clause."). Therefore, the producer should not have a duty to mitigate damages by selling gas to a third party (even if the pipeline would permit this). *Stack v. Tenneco, Inc.*, No. E83-0143(L), slip op. at 9 n.7 (E.D. Miss. Oct. 23, 1987); *ANR Pipeline Co. v. Union Oil Co.*, No. CIV-89-533-R, slip op. at 8-10 (W.D. Okla. Oct. 16, 1989).

Applying § 2-708(1) should yield a similar result because no recoupment rights exist in years when no deficiency payments are made. See *R.J.B. Gas Pipeline Co.*, 813 P.2d at 24-25; *RJB Gas Pipeline Co. v. Colorado Interstate Gas Co.*, 813 P.2d 1, 11 (Okla. Ct. App. 1989).

25. UCC § 2-708 is limited to setting forth the measure of recovery for non-acceptance or repudiation by the buyer. When neither non-acceptance nor repudiation is present, UCC § 2-708 does not apply. See, e.g., *Beco, Inc. v. Minnechaug Golf Course, Inc.*, 256 A.2d 522, 525-26 (Conn. Cir. Ct. 1968). Typically, a producer does not sue a pipeline for non-acceptance because the pipeline is specifically permitted by the take-or-pay clause to not take the gas. E.g., *Transcontinental Gas Pipe Line Corp. v. State Oil & Gas Bd.*, 474 U.S. 409, 412 (1986); *Prenalta Corp.*, 944 F.2d at 680; *Golsen v. ONG W., Inc.*, 756 P.2d 1209, 1210 (Okla. 1988). Repudiation by the buyer triggers a § 2-708(1) remedy only if the seller brings a claim for anticipatory repudiation. The producer normally seeks relief only for the pipeline's failure to make deficiency payments due under the contract, and not for failure to take the gas or for repudiation of future payments.

26. E.g., OKLA. STAT. tit. 23, § 22 (1981) (suit for breach of obligation to pay money). In *R.J.B. Gas Pipeline Co.*, 813 P.2d at 24, the court found this section inapplicable to take-or-pay damages.

Producers should provide for interest on late payments in the contract. Such provisions are enforceable. E.g., OKLA. STAT. tit. 15, §§ 266, 275 (1981); *First Nat. Bank v. Citizens & S. Bank*, 651 F.2d 696, 699 (10th Cir. 1981). Similarly, the contract should provide attorneys' fees for the prevailing party in a suit to enforce the contract. In some states, the absence of such a provision precludes the award of attorneys' fees. In Oklahoma, a gas purchase contract is a sale of goods and thus subject to the attorney fee provision in OKLA. STAT. tit. 12, § 936 (1981). See *R.J.B. Gas Pipeline Co.*, 813 P.2d at 24. A fee provision in the contract is still advisable because under fee statutes, a court may sometimes reduce a fee request to an amount that it deems "reasonable." Cf. *Bishop v. Franks*, 107 P.2d 358, 359-60 (Okla. 1940) (noting distinction between a court in equity awarding fees based on quantum meruit and fees under a contract provision).

statutory amount, it was victorious each day payment was delayed. Producers also asserted RICO,²⁷ anti-trust,²⁸ and tortious breach of contract claims²⁹ against the pipeline, all of which would have supported enhanced recovery. However, all such claims were universally unsuccessful. In addition, producers occasionally attempted to recover under the doctrine of anticipatory repudiation.³⁰ In exceptional situations producers sought injunctive and provisional remedies.

V. THE PIPELINE'S "GENERIC" DEFENSES

Past take-or-pay litigation focused not on the producer's prima facie case for breach of contract by the pipeline, but rather on the pipeline's excuses for breach.³¹ Labeled "generic defenses,"³² the excuses applied

27. See, e.g., *Samson Resources Co. v. Northern Natural Gas Co.*, No. 85-C-911-E (N.D. Okla. July 1, 1987) (granting motion to dismiss RICO claim); *Cayman Exploration Corp. v. United Gas Pipeline Corp.*, No. 86-C-123-B, slip op. at 16-26 (N.D. Okla. Jan. 5, 1987) (same). See generally Denis Binder, *The Potential Application of RICO in the Natural Resources/Environmental Law Context*, 63 DENV. U. L. REV. 535 (1986).

28. See, e.g., *Cayman Exploration Corp.*, No. 86-C-123-B, slip op. at 6-16 (granting motion to dismiss federal antitrust claim); *Garshman v. Universal Resources Holding, Inc.*, 641 F. Supp. 1359, 1367-69 (D.N.J. 1986) (dismissing federal antitrust claim that pipeline coerced producers to renegotiate take-or-pay contracts by threatening economic reprisals), *aff'd*, 824 F.2d 223 (3d Cir. 1987); cf. *Colorado Interstate Gas Co. of Am. v. Natural Gas Pipeline Co.*, 885 F.2d 683, 691-97 (10th Cir. 1989) (reversing lower court judgment in favor of natural gas seller on antitrust monopoly count against transporter because seller failed to establish dangerous probability that transporter would monopolize the long-distance transportation market), *cert. denied*, 111 S. Ct. 441 (1990); *Illinois ex rel. Hartigan v. Panhandle E. Pipe Line Co.*, 730 F. Supp. 826 (C.D. Ill. 1990) (unsuccessful suit by state against pipeline), *aff'd*, 935 F.2d 1469 (7th Cir. 1991). See generally William C. Holmes et al., *Dealing with Pipeline Monopolies: The Antitrust Alternative*, 37 INST. ON OIL & GAS L. & TAX'N § 7.01 (1986) (discussing antitrust principles of third party access to pipeline transportation systems).

29. *RJB Gas Pipeline Co. v. Colorado Interstate Gas Co.*, 813 P.2d 1, 11-12 (Okla. Ct. App. 1989). *But see American Nat'l Petroleum Co. v. Transcontinental Gas Pipe Line Corp.*, 798 S.W.2d 274 (Tex. 1990) (upholding punitive damages against pipeline and concluding that pipeline took unfair advantage of smaller companies). See generally Lawrence A. Towers & Peter L. Gardon, *Circumvention of Article 2: Tort Remedies for Breach of Contract*, 19 UCC L.J. 291 (1987) (discussing tort remedies to breach of contract in a commercial setting).

30. Producer's anticipatory repudiation claims were based on UCC § 2-610. See, e.g., *El Paso Natural Gas Co. v. G.H.R. Energy Corp.*, No. 85-09329 (Tex. Dist. Ct. Harris County Mar. 21, 1988) (jury verdict of \$536 million based on anticipatory repudiation by the pipeline); cf. *Kaiser-Francis Oil Co. v. Producer's Gas Co.*, No. 83-C-400-B (N.D. Okla. June 19, 1985) (granting summary judgment against producer on claim of anticipatory repudiation).

31. See *Northwestern Mut. Life Ins. Co. v. ANR Pipeline Co.*, No. H-86-2189, 1987 WL 5677 (S.D. Tex. Jan. 16, 1987) (noting that take-or-pay defenses are commonly asserted against a standard industry contract); John S. Dzienkowski, *Professional Responsibility Trends for Lawyers and Landmen in Natural Resources Transactions*, 36 ROCKY MTN. MIN. L. INST. § 2.01, § 2.04[7], at 2-46 to -47 (1990) (positing that take-or-pay defenses are largely independent of contract language). After generic defenses proved largely unsuccessful, pipelines increasingly relied on contract-specific defenses. See *Pierce*, *supra* note 9, § 1.03[2][c].

32. Medina, *Take or Litigate*, *supra* note 3, at 210, reprinted in 24 PUB. LAND & RESOURCES L. DIG. at 192.

industry-wide and were largely unrelated to specific gas purchase contracts. Although pipelines failed with generic defenses, an understanding of the defenses is necessary to construct effective natural gas contract clauses.

A. *NGPA Defense*

A common defense asserted by buyers in natural gas contract litigation involved the Natural Gas Policy Act of 1978 ("NGPA").³³ The NGPA established maximum prices for certain categories of natural gas. Buyers contended that deficiency payments for gas not taken would effectively raise the price for gas taken above the NGPA's maximum lawful price. This defense was universally rejected and is of historic interest only because natural gas prices are almost completely deregulated.³⁴

B. *Mutual Mistake Defense*

Pipelines often contended that their breach was justified because the gas purchase contract was formed on the basis of a mutual mistake of the parties. Generally, pipelines claimed that the parties mistook either the projected economic conditions of the natural gas market or the impact of governmental regulation on the natural gas industry. The courts rejected this defense on a number of grounds.³⁵ First, pipelines were unable to establish the mutuality of the mistake. Second, pipelines assumed the risk of a decline in the price of natural gas; therefore, the defense was inapplicable. Third, a mutual mistake regarding predictions of future conduct was not the type of mistake for which the courts could grant relief. Lastly, the defense carried with it a higher burden of proof which pipelines were unable to sustain.³⁶

33. Pub. L. No. 95-621, 92 Stat. 3350 (codified as amended at 15 U.S.C. §§ 3301-3432 (1988)).

34. *E.g.*, *Kaiser-Francis Oil Co. v. Producer's Gas Co.*, 870 F.2d 563, 570 (10th Cir. 1989) (rejecting assertion of the NGPA defense); *Associated Gas Distribs. v. FERC*, 893 F.2d 349, 357-59 (D.C. Cir. 1989) (same); *Transcontinental Gas Pipe Line Corp.*, 51 F.E.R.C. ¶ 61,322 (1990); see *Pierce*, *supra* note 9, § 1.03[2][b] (discussing NGPA defense).

35. *See, e.g.*, *Sabine Corp. v. ONG W., Inc.*, 725 F. Supp. 1157, 1187-89 (W.D. Okla. 1989) (striking defense because evidence did not show that mistake was mutual); *Resources Inv. Corp. v. Enron Corp.*, 669 F. Supp. 1038, 1042-43 (D. Colo. 1987) (holding a mutual mistake defense was not applicable to mistaken predictions of future economic conditions).

36. *See, e.g.*, *Sabine Corp.*, 725 F. Supp. at 1187-89 (in Oklahoma, the burden of proof is a clear and convincing evidentiary standard for reformation or rescission based on mutual mistake). *But cf.* *Wagner & Brown II v. ONEOK, Inc.*, No. CIV-89-943-R, slip op. at 22-23 (W.D. Okla. Mar. 29, 1990) (allowing mistake defense to survive motion to dismiss but narrowing its scope). *See generally* 2 E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS § 9.3 (1990) (discussing mutual mistake defense to enforcement of a contract).

C. *Public Policy Defense*

The public policy defense was used by public utilities and their intermediate purchasers as a defense to enforcement of take-or-pay obligations. Public utilities contended that take-or-pay clauses were against public policy because the consumer would suffer higher utility prices resulting from deficiency payments if the clauses were enforced. The public utilities argued that higher prices would lead to lower consumption, then to less revenues, necessitating still higher rates, further reducing revenues and so on, thereby creating damage to the rate-making structure.³⁷ Courts rejected the defense because the deficiency payments would not necessarily lead to higher consumer prices. Also, courts universally held that the freedom to contract outweighed any potential adverse effects on utility consumers.³⁸

D. *Penalty Defense*

Buyers argued that the take-or-pay clause in the gas purchase contract constituted a penalty because the central feature of the clause was the requirement that the buyer pay for gas not taken. Courts, however, universally held that take-or-pay clauses do not provide a punishment for breach, rather an alternative method of performance.³⁹ Under a typical

37. This so-called "death spiral" proceeds "whereby the need to raise price[s] to cover average cost results in a loss of sales sufficiently large that price must be raised again—and so on, until the market must be abandoned." J. Stephen Henderson, *Price Discrimination Limits in Relation to the Death Spiral*, ENERGY J., July 1986, at 33, 34. The death spiral theory fails because it does not consider that stockholders of the utility should suffer the loss, not the producer or consumer. See Clyde E. Milligan, *Anatomy of a Gas Purchase Contract*, 23 ROCKY MOUNTAIN L. INST. 771, 775 (1977); cf. Madelyn M. Huffmire, *Section 2-615 and Corporate Accountability*, 13 UCC L.J. 256 (1981). For an example of this alternative, see *Northern Ind. Pub. Serv. Co. v. Carbon County Coal Co.*, 799 F.2d 265, 274-76 (7th Cir. 1986) (refusing to allow the costs associated with long-term contracts to pass through to the ratepayers).

38. See, e.g., *Sabine Corp.*, 725 F. Supp. at 1182-83 (upholding the freedom to contract and finding no evidence of contravention of public policy in take-or-pay clause); *Benson Mineral Group, Inc. v. Northern Natural Gas Co.*, No. 86-1903, slip op. at 18-20 (D. Kan. April 29, 1988); *Day v. Tenneco, Inc.*, 696 F. Supp. 233, 237 (S.D. Miss. 1988) (noting that even if the take-or-pay clause raises the price of gas for consumers, the clause "would not for that reason violate public policy"); *Resources Inv. Corp.*, 669 F. Supp. at 1040 ("[E]nsuring that parties adhere to the terms of contracts they have entered into far outweighs the purported interest in protecting [the buyer] from agreements they now perceive to have been unwise.").

39. See, e.g., *Prenalta Corp. v. Colorado Interstate Gas Co.*, 944 F.2d 677, 688-90 (10th Cir. 1991); *Wagner & Brown II*, No. CIV-89-943-R, slip op. at 20-22; *ANR Pipeline Co. v. Union Oil Co.*, No. CIV-89-533-R, slip op. at 1-3 (W.D. Okla. Oct. 16, 1989); *Sabine Corp.*, 725 F. Supp. at 1184 (noting that deficiency payments are an alternate performance to presently taking and paying for gas, not a penalty for breach); *Northwest Cent. Pipeline Corp. v. Mesa Petroleum Co.*, No. 7159, 1985 WL 44696, at *4 (Del. Ch. Apr. 10, 1985); cf. 1 WHITE & SUMMERS, *supra* note 19, § 7-18 (rejecting application of liquidated damages theory so as to preclude enforcement of take-or-pay contracts). See generally 3 FARNSWORTH, *supra* note 36, § 12.18.

take-or-pay clause, the buyer had the choice of taking and paying for the annual minimum volume during an accounting year or paying for the annual minimum volume during the accounting year and taking the gas paid for during a later accounting year. Furthermore, if the take-or-pay clause were a penalty, payment of that penalty would extinguish further obligations of the pipeline under the contract. This result was clearly contrary to the pipelines' continuing obligations under the contract; therefore, this defense usually failed.

E. *Unconscionability Defense*

Under the authority of UCC section 2-302, a court has the power to refuse to enforce any part of a contract that it finds unconscionable. In defending alleged breaches pipelines argued that take-or-pay provisions were unconscionable parts of the contract and resulted from unequal bargaining powers of the parties. Pipelines theorized that producers used enormous bargaining power created by the great gas shortages in the 1970s to force pipelines to accept adhesion contracts.

Courts rejected this defense on several grounds. First, pipelines, not producers, drafted most gas purchase contracts. Second, despite the gas shortages, pipelines retained significant marketing and negotiating leverage. Third, unconscionability played a very limited role in commercial contracts.⁴⁰ Finally, the defense failed on the threshold requirement that the unconscionability must be determined in light of the circumstances existing at the time of the contract execution, not at the time of the dispute.⁴¹ Most take-or-pay contracts were part of a bargained for exchange: the producer's long-term commitment of a gas supply for the pipeline's guarantee of a continuous stream of revenue.⁴²

40. U.C.C. § 2-302(1), 1A U.L.A. 15 (1989). See Jane P. Mallor, *Unconscionability in Contracts Between Merchants*, 40 SW. L.J. 1065 (1986); 2 ANDERSON, *supra* note 20, § 2-302:39; 2 HAWKLAND, *supra* note 20, § 2-302:06; cf. Gerald B. Greenwald, *Natural Gas Contracts Under Stress: Price, Quantity and Take or Pay*, 5 J. ENERGY & NAT. RESOURCES L. 1 (1987).

41. U.C.C. § 2-302(1). See 2 ANDERSON, *supra* note 20, § 2-302:47 (determining unconscionability as of the time of contracting); 2 HAWKLAND, *supra* note 20, § 2-302:05 (discussing limitations of the unconscionability doctrine).

42. "It should make a lawyer blush to stand before a court and argue that a contract negotiated by gas pipeline executives (with the assistance of counsel) contained a clause that was unconscionable at the time it was written." 1 WHITE & SUMMERS, *supra* note 19, § 7-18, at 33 (Supp. 1991). See, e.g., *Resources Inv. Corp.*, 669 F. Supp. at 1042 (D. Colo. 1987) (rejecting unconscionability); *Benson Mineral Group, Inc.*, No. 86-1903, slip op. at 18-20 (finding that contract was not unconscionable at the time it was executed); *Brumark Corp. v. Northern Natural Gas Co.*, No. C-87-46 (Okla. Dist. Ct. Roger Mills County Feb. 21, 1989).

F. *Commercial Impracticability Defense*

Buyers also sought refuge from their contractual obligations under the provisions of UCC section 2-615. That section excuses the seller and buyer⁴³ when performance is impracticable because of the occurrence of a contingency that was not contemplated by the parties at the time of contracting.

The impracticability defense was also unsuccessful.⁴⁴ Courts held that governmental or regulatory intervention in natural gas sales was foreseeable at the time of contracting and not a contingency that would give rise to a commercial impracticability defense. Courts also determined that, in the absence of a protective clause, pipelines assumed the risk of governmental regulation and declining markets. Moreover, in order to raise commercial impracticability as a defense, the pipeline was required to avail itself of any regulatory avenues of relief. Finally, because the take-or-pay contract was an alternative contract, the pipeline had to establish that it was commercially impracticable to both take the gas and pay for the gas not taken.

G. *Conservation Defense*

Pipelines, principally in Oklahoma and Texas, attempted to use conservation laws as a defense to take-or-pay obligations.⁴⁵ In Oklahoma, such reliance was unsuccessful for interstate pipelines because of federal preemption of state law.⁴⁶ Other Oklahoma pipelines unsuccessfully

43. Although UCC § 2-615 expressly includes only sellers, the provisions were judicially extended to buyers. *Lawrance v. Elmore Bean Warehouse, Inc.*, 702 P.2d 930, 932 (Idaho Ct. App. 1985); *Nora Springs Coop. v. Brandau*, 247 N.W.2d 744 (Iowa 1976); *Golsen v. ONG W., Inc.*, 756 P.2d 1209, 1221 (Okla. 1988) (Kauger, J., concurring).

44. "The impracticability argument has been equally unavailing for the [pipeline companies]." 1 WHITE & SUMMERS, *supra* note 19, § 7-18, at 33 (Supp. 1991). See *Wagner & Brown II v. ONEOK, Inc.*, No. CIV 89-943-R, slip op. at 6-12 (W.D. Okla. Mar. 29, 1990); *Sabine Corp. v. ONG W., Inc.*, 725 F. Supp. 1157, 1172-78 (W.D. Okla. 1989). Cases applying UCC § 2-615 are collected in Jane M. Draper, Annotation, *Impracticability of Performance of Sales Contract as Defense Under UCC § 2-615*, 93 A.L.R.3d 584 (1979); cf. Medina, *A Further Status Report*, *supra* note 3, at 408 n.108. See generally 2 FARNSWORTH, *supra* note 36, §§ 9.5, 9.6 (discussing commercial impracticability under UCC § 2-615). For non-UCC cases that hold inability to pay cannot be excused under the doctrine of impracticability, see *Deibel v. Deibel*, 512 F. Supp. 135 (E.D. Mo. 1981); *Haun v. King*, 690 S.W.2d 869 (Tenn. Ct. App. 1984).

45. See Medina et al., *Take or Litigate*, *supra* note 3, at 242-52, reprinted in 24 PUB. LAND & RESOURCES L. DIG. at 249-54.

46. *ANR Pipeline Co. v. Corporation Comm'n*, 643 F. Supp. 419 (W.D. Okla. 1986), *aff'd*, 860 F.2d 1571 (10th Cir. 1988), *cert. denied*, 490 U.S. 1051 (1989).

raised waste and rateable take regulation defenses.⁴⁷ In Texas, the nomination procedure used by the Railroad Commission invited pipeline manipulation. By nominating very little gas over a period of time, a pipeline was able to reduce the amount of gas the producer would be allowed to produce from a well. The pipeline argued the limited allowable was the basis on which to calculate the minimum quantity for take-or-pay purposes. Texas courts split on the issue of whether the minimum quantity is affected by nomination. The majority rejected the defense.⁴⁸

H. *Force Majeure Defense*

Force majeure is a generic defense that depends upon contract language for success. In past litigation, pipelines argued two conditions of force majeure: a drastically different natural gas market and intervening governmental regulations. Courts vigorously employed the canon of *ejusdem generis* to narrow the scope of force majeure clauses in natural gas contracts. In addition, courts required pipelines to establish force majeure for all the alternative means of performances, not simply the alternative of presently taking the gas. For the most part, the force majeure defense was unsuccessful.⁴⁹

47. *E.g.*, *Sabine Corp.*, 725 F. Supp. at 1183-84; *Panhandle E. Pipeline Co. v. Corporation Comm'n*, 715 F. Supp. 1055 (W.D. Okla. 1989); *Golsen*, 756 P.2d at 1214-20; *Brumark Corp. v. Northern Natural Gas Co.*, No. C-87-46, slip op. at 8 (Okla. Dist. Ct. Roger Mills County Feb. 21, 1989).

48. For cases disallowing the defense, see *Oakridge Energy, Inc. v. Lone Star Gas Co.*, No. 130,044-C (Tex. Dist. Ct. Wichita County June 18, 1990); *Brown v. El Paso Natural Gas Co.*, No. 34,578 (Tex. Dist. Ct. Midland County July 12, 1988); *Wagner & Brown II v. Valero Transmission Co.*, No. 36,160 (Tex. Dist. Ct. Midland County May 4, 1987); *Hamilton Bros. Oil Co. v. Lone Star Gas Co.*, No. 86-233 (Tex. Dist. Ct. Cooke County Sept. 22, 1987).

For cases allowing the defense, see *Danden Petroleum, Inc. v. Northern Natural Gas Co.*, 615 F. Supp. 1093 (N.D. Tex. 1985); *Lone Star Gas Co. v. Lively Energy & Dev. Corp.*, No. 04-87-00261-CV (Tex. App.—San Antonio Oct. 11, 1989, no writ) (finding issue properly one for the jury, which found for the pipeline). See also A. Scott Anderson, *The Texas Approach to Gas Proration and Ratable Take*, 57 U. COLO. L. REV. 199 (1986).

49. See, *e.g.*, *Kaiser-Francis Oil Co. v. Producer's Gas Co.*, 870 F.2d 563, 565-66 (10th Cir. 1989); *Conn Energy, Inc. v. Sea Robin Pipeline Co.*, No. 89-5436, 1990 WL 62020 (E.D. La. May 9, 1990); *Sabine Corp.*, 725 F. Supp. at 1162-72; *United States v. Panhandle E. Corp.* 693 F. Supp. 88, 95-99 (D. Del. 1988), *aff'd*, 868 F.2d 1363 (3d Cir. 1989); see also *Pierce*, *supra* note 9, § 1.03[2][a] (discussing *Sabine* and *Kaiser-Francis*); *cf.* *Esplanade Oil & Gas, Inc. v. Templeton Energy Income Corp.*, 889 F.2d 621 (5th Cir. 1989) (holding force majeure clause did not excuse performance of buyer because precipitous drop in oil prices made performance merely unprofitable, not impossible). *But see Exxon Corp. v. ANR Pipeline Co.*, No. H-89-1011 (S.D. Tex. Sept. 19, 1990) (granting partial summary adjudication to pipeline).

VI. SPECIFIC CONTRACT CLAUSE LITIGATION: THE PAST AND ITS LESSONS FOR THE FUTURE

Future gas purchase contracts should be drafted only after analyzing the impact of specific clauses and the construction of such clauses in past litigation.⁵⁰ The outcome of past litigation, which focused on the generic defenses, was largely independent of contract language. Now, after generic defenses have proven largely unsuccessful, the outcome of take-or-pay litigation depends mainly upon the language in the contract. This section of the paper examines specific provisions of a gas purchase contract that have impacted a pipeline's take-or-pay obligation. Examination of these provisions will aid the drafting of future contracts, whether or not a take-or-pay clause is utilized. Scrutiny of these specific contract provisions reveals one basic truth: a party is best protected by strict, meticulous and scrupulous compliance with the provisions of the contract. Even the most inane and innocuous sounding provision can rear its ugly head and severely bite a party.⁵¹

A. *Force Majeure Clause*

Typically, force majeure clauses were not negotiated. Instead, they were buried deep in the boilerplate provisions of long-term gas contracts. One would assume that force majeure provisions would have benefitted the pipelines because they drafted most gas purchase contracts.⁵² This has not been the case. In fact, the object lesson from force majeure disputes must be that boilerplate provisions oftentimes fail. The drafter must put careful thought into the preparation of the force majeure clause to make it effective.⁵³

50. After unsuccessful resolution of the generic defenses, pipelines returned to the specific contract for relief. *Pierce*, *supra* note 9, § 1.03[2][c]. The pipelines often found protection in the terms of the contract. *Id.*

51. *Id.* § 1.03[2].

In the take-or-pay arena, both sides have been surprised to learn the effect of their *entire* gas contract. Purchasers have been surprised to learn that, absent express contract language, courts will not rescue them from dramatic market shifts. Producers have been equally surprised to learn that courts will give effect to "all that pipeline boilerplate" which often substantially reduces or eliminates the purchaser's take-or-pay obligations.

Id. (footnotes omitted).

52. The buyer, in most cases a pipeline or a utility, had prepared the gas purchase contract. *Coquina Oil Corp. v. Transwestern Pipeline Co.*, No. 86-562-M Civil (D.N.M. Sept. 19, 1986), *appeal dismissed*, 825 F.2d 1461 (10th Cir. 1987); Patrick J. McCarthy, *The Purchaser's Considerations in the Negotiation and Drafting of Gas Contracts*, 19 ROCKY MTN. MIN. L. INST. 237, 240-41 (1974).

53. While most pipelines have not practiced careful drafting, ANR Pipeline Company has enjoyed success with its force majeure defense. *See, e.g., Exxon Corp.*, No. H-89-1011 (granting ANR's motion for partial summary judgment on the issue of force majeure); Hamilton Bros. Oil Co.

Many pipelines' claims of force majeure failed on the requirement to give notice. A force majeure clause contains three basic elements: the requisite notice to be given, the definition of the types of activities or situations that would constitute force majeure, and the effect of those activities on the parties' obligations. Courts have consistently ruled that the notice specified in the force majeure clause was a condition precedent to the existence of the defense. Without such specified notice, the defense would fail as a matter of law.⁵⁴ A producer responding to a force majeure assertion is better able to show lack of the requisite notice if the requirements of notice are detailed and exacting. Thus, a producer might insert a clause similar to that below:

The party asserting a condition of force majeure as defined herein shall provide written notice by certified mail (return receipt requested) to the other party within five days of such condition's occurrence. This written notice shall specify (1) the nature of the force majeure condition, (2) the length of time such condition is expected to continue, and (3) the efforts expended and to be expended by the party claiming a condition of force majeure to remedy or alleviate the condition of force majeure.

Courts have narrowly construed events covered by force majeure in favor of the producer. Pipelines often attempted to fit the event of falling gas prices into force majeure clause language such as "failure of market."

v. ANR Pipeline Co., No. CIV-88-132-A (W.D. Okla. Feb. 21, 1989) (allowing force majeure defense to survive producer's motion for summary judgment); *Burkhart Petroleum Corp. v. ANR Pipeline Co.*, No. 87-C-257-C (N.D. Okla. June 30, 1988) (allowing force majeure defense). Indeed, ANR has received favorable trial decisions on its defense. See *Dyco Petroleum Corp. v. ANR Pipeline Co.*, No. 86-C-1097-E (N.D. Okla. Aug. 29, 1990) (jury verdict largely favorable to ANR); *Atlantic Richfield Co. v. ANR Pipeline Co.*, 768 S.W.2d 777, 781-82 (Tex. App.—Houston [14th Dist.] 1989, no writ) (FERC order no. 380 allowing pipeline customers to refuse to pay pipeline "minimum bills" constituted force majeure and excused pipelines take-or-pay obligations to producer). ANR had precise contract language directly tying the take-or-pay deficiency clause to the force majeure provision:

Notwithstanding anything to the contrary contained herein, on any day when deliveries or takes are affected by force majeure and the volumes of gas well gas delivered are less than the applicable daily contract quantity, the daily contract quantity hereunder shall be deemed to be the actual volume delivered and purchased on each such day.

Id. at 780 (quoting FERC order no. 380, art. V, § 8). See also *Pierce*, *supra* note 9, § 1.03[2][a] (discussing *ANR*). *ANR*'s precise facts were not easily duplicated by other pipelines. Transcript of Hearing on Motions for Summary Judgment at 8-10, *Quinton Little Co. v. Lone Star Gas Co.*, No. 37-427-C (E.D. Okla. Jan. 5, 1989).

54. *International Minerals & Chem. Corp. v. Llano, Inc.*, 770 F.2d 879, 885 (10th Cir. 1985), *cert. denied*, 475 U.S. 1015 (1986); *Superior Oil Co. v. Transco Energy Co.*, 616 F. Supp. 98, 108-09 (W.D. La. 1985); *Sabine Corp. v. ONG W., Inc.*, 725 F. Supp. 1157, 1168-69 (W.D. Okla. 1989); see *Wagner & Brown II v. ONEOK, Inc.*, No. CIV 89-943-R, slip op. at 3-6 (W.D. Okla. Mar. 29, 1990) (striking force majeure defense because pipeline sent notice of force majeure to the operator, not to the seller as required by the contract).

Courts, however, interpreted such force majeure clauses under the doctrine of *ejusdem generis*⁵⁵ and held that falling prices did not constitute “failure of market,” but simply made operations unprofitable. Although pipelines lost most force majeure arguments,⁵⁶ clearer contract language might have prevented the disputes and attendant litigation expenses. Thus, a party is wise to carefully consider the events covered by a force majeure clause. A producer desiring to exclude market fluctuations or governmental activities from covered events, might use the following language:

The term “force majeure” shall be strictly and narrowly limited to only natural, operational, and mechanical events not within the control of the party claiming suspension, and which by the exercise of due diligence, such party is unable to prevent or overcome, such as storms, floods, breakages or accidents to machinery or lines of pipe, freezing of wells or pipes, or necessity for making repairs and the like. In no event shall force majeure be defined or construed to include events arising out of, relating to, or caused by governmental, market, or economic conditions.

The third element of a force majeure clause specifies which duties are suspended in the event of force majeure. For example, if a seller had a very strong negotiating position with a buyer, the seller might insist on language such as:

55. See, e.g., *Wheeling Valley Coal Corp. v. Mead*, 186 F.2d 219, 223 (4th Cir. 1950); *Consolidated Gas Transmission Co. v. Ashland Exploration, Inc.*, No. 87-C-103-1, slip op. at 8 (W. Va. Cir. Ct. Harrison County Oct. 13, 1988). See generally 2 FARNSWORTH, *supra* note 36, § 9.9a; 18 SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 1968, at 209-11 (3d ed. 1978); Edmund M. Carney, *The Nature and Extent of the Excuse Provided by a Force Majeure Event Under a Coal Supply Agreement*, 4 E. MIN. L. INST. § 11.01, § 11.02[1][c][iii] (1983); Gregory P. Williams, *Coping with Acts of God, Strikes, and Other Delights—The Use of Force Majeure Provisions in Mining Contracts*, 22 ROCKY MTN. MIN. L. INST. 433, 434-36 (1976). For application in a non-gas context, see *United States v. Brooks-Callaway Co.*, 318 U.S. 120, 122-24 (1943).

56. See *Kaiser-Francis Oil Co. v. Producer's Gas Co.*, 870 F.2d 563, 566 (10th Cir. 1989) (“The change in the general or relative resale price of gas does not constitute a ‘partial failure of gas demand’ [under the force majeure clause] which would relieve [the pipeline] of its obligations to take or pay.”); *Golsen v. ONG W., Inc.*, 756 P.2d 1209, 1212-14 (Okla. 1988) (holding that inability to sell gas at a profit does not constitute “failure of gas supply or market,” an event described in the force majeure clause). *But cf. Kodiak 1981 Drilling Partnership v. Delhi Gas Pipeline Corp.*, 736 S.W.2d 715, 724 (Tex. App.—San Antonio 1987, writ ref’d n.r.e.) (holding that failure of a market for the gas relieved purchaser of take-or-pay obligations). Commentators have criticized *Kodiak*. See, e.g., *Discussion Notes*, 99 Oil & Gas Rep. (MB) 631-32 (Aug. 1989). For analysis of *Golsen*’s significance, see Robert N. Barnes & Randall J. Wood, *The Allocation of Risk in Gas Purchase Contracts After Golsen v. ONG Western, Inc.*, 13 OKLA. CITY U. L. REV. 503 (1988); David L. Kearney, *The Take-or-Pay Controversy from the Pipeline Perspective*, 13 OKLA. CITY U. L. REV. 479 (1988).

Each party hereto shall be excused from performing under this agreement, except for buyer's obligation to make payments accrued hereunder, prior to, during, or after the occurrence of the cause relied upon, to the extent

On the other hand, a buyer might insist that the force majeure excuse all its obligations except for the payment of gas taken prior to the occurrence of the force majeure.

B. *Assignment and/or Ownership Clause*

Assignment or ownership clauses require the producer to give notice to the purchaser (pipeline) of assignments or transfers of ownership. Certain types of these clauses impose strict requirements on the producer before an assignment is binding on the purchaser (pipeline). An example of such a clause is shown below:

No transfer, assignment, conveyance, or encumbrance of any kind, of any interest whatsoever in respect of which production is delivered to buyer hereunder shall be binding upon buyer until buyer shall have been given written notice thereof and furnished with duly certified copies of records evidencing the same.

In one case in which this author participated, the assignment clause took on crucial meaning. The producers (both the assignor and assignee) gave the pipeline notice of the transfer of ownership through execution of division orders and correspondence. However, they did not give the pipeline certified copies of the transfer as required by the contract. The legitimacy of the transfer of ownership was crucial because the assignor (but not the assignee) had signed offers of credit through which the pipeline had accrued substantial credit rights against the assignor. During a settlement conference, the presiding magistrate indicated to the producer that failure to comply with the strict language of the assignment clause might be fatal to the case, inasmuch as the credits built up against the assignor were more than enough to offset the take-or-pay claim.⁵⁷

57. Other cases involving similar facts have been found. *See, e.g.,* Prima Energy Corp. v. Panhandle E. Pipe Line Co., No. 89 CV 331, slip op. at 9 (Colo. Dist. Ct. Weld County Oct. 5, 1990) (enforcing assignment notice clause); R.J.B. Gas Pipeline Co. v. Colorado Interstate Gas Co., 813 P.2d 14, 19-20 (Okla. Ct. App. 1990) (reversing award and remanding because pipeline company was not allowed to rebut evidence that notice or a copy of assignments was given to it as required by contract). *But see* Lone Mountain Prod. Co. v. Natural Gas Pipeline Co. of Am., 710 F. Supp. 305, 309-12 (D. Utah 1989) (holding that failure to strictly comply with formalities of assignment provision not fatal to recovery by producer, because the pipeline company was barred by waiver and estoppel to assert the defense). *Lone Mountain* is analyzed in Pierce, *supra* note 9, § 1.03[2][d]. *See generally* David E. Pierce, *An Analytical Approach to Drafting Assignments*, 44 Sw. L.J. 943 (1990).

C. Arbitration Clause

An arbitration clause in a gas purchase contract may decrease the time and costs required for resolution of disputes. However, an arbitration clause limits the ability of the parties to seek relief from the courts. Consequently, careful drafting of such clauses is imperative.

Arbitration provisions were contained in many natural gas contracts.⁵⁸ Courts favored arbitration clauses in the name of public policy,⁵⁹ and upheld limitations on appellate review of arbitrator decisions.⁶⁰

58. See D.H. Gregg, *Negotiating and Drafting Gas Purchase Contracts on Behalf of the Seller*, 13 INST. ON OIL & GAS L. & TAX'N 87, 142 (1962); Milligan, *supra* note 37, at 801; Lewis G. Mosburg, Jr., *Analysis of Producer Gas Sale Contracts*, 17 OKLA. L. REV. 249, 281 (1964); William D. Watson, *The Natural Gas Policy Act of 1978 and Gas Purchase Contracts*, 27B ROCKY MTN. MIN. L. INST. 1407, 1430-31 (1982). A typical arbitration clause is shown below:

Any controversy arising from determination or redetermination of prices between the parties not resolved by agreement shall be determined by a board of arbitration upon notice of submission given either by Buyer or Seller, which request shall also name one arbitrator. The party receiving such notice, shall, within ten (10) days thereafter, by notice to the other, name the second arbitrator, or failing so to do, the party giving notice of submission shall name the second. The two (2) arbitrators so appointed shall name the third, or failing to do so within ten (10) days the third arbitrator may be appointed by the person who is at the time the Senior (in service) Judge of the United States District Court for that District in which the leases covered hereby are situated.

The arbitrators selected to act hereunder shall be qualified by education, experience and training to pass upon the particular question in dispute.

The arbitrators so appointed shall promptly hear and determine (after giving the parties due notice of hearing and a reasonable opportunity to be heard) the questions submitted and shall render their decision within sixty (60) days after appointment of the third arbitrator. If within said period a decision is not rendered by a board or a majority thereof, new arbitrators may be named and shall act hereunder at the election of either Buyer or Seller in like manner as if none had been previously named.

The decision of the arbitrators, or of majority thereof, made in writing shall be final and binding upon the parties hereto as to the questions submitted and the parties will abide by and comply with such decision. Each party shall bear the expenses of its arbitrator, and the expenses of the third arbitrator shall be borne equally by the Buyer and Seller except that each party shall bear the compensation and expense of its counsel, witnesses and employees.

59. See, e.g., *Gilmer v. Interstate/Johnson Lane Corp.*, 111 S. Ct. 1647 (1991) (enforcing arbitration clause in an employment agreement that precluded a separate age discrimination suit); *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 238-42 (1987) (subjecting RICO claim to arbitration agreement). Federal law and a majority of states provide for arbitration. See 9 U.S.C.A. §§ 1-16 (West 1970 & Supp. 1991); UNIF. ARBITRATION ACT, 7 U.L.A. 1 (Supp. 1991) (table of jurisdictions enacting the Act).

60. *United Paperworkers Int'l Union v. Misco, Inc.*, 484 U.S. 29, 36-38 (1987); *United Steelworkers v. American Mfg. Co.*, 363 U.S. 564, 567-68 (1960). Grounds for vacating the arbitration award are set out in the federal statute at 9 U.S.C.A. § 10 (West Supp. 1991) and in the Oklahoma Statutes at OKLA. STAT. tit. 15, § 812 (1981). See Margaret Shulenberg, Annotation, *Construction and Application of § 10(a-d) of United States Arbitration Act of 1947 (9 USCS § 10(a-d))*, *Providing Grounds for Vacating Arbitration Awards*, 20 A.L.R. FED. 295 (1974) (collection of cases). An error of law, by itself, will not justify reversal of the arbitration award. See Medina, *A Report from the Battle Zone*, *supra* note 3, at 2564 n.71, reprinted in 24 PUB. LAND & RESOURCES L. DIG. at 278 n.71. In some jurisdictions an arbitrator may award punitive damages even if a court would not. See

However, application of arbitration to natural gas and other natural resources transactions has met with mixed reviews from commentators.⁶¹ The litigation history in the courts indicates that arbitration agreements will be enforced,⁶² even when the arbitration award involves fairly creative remedies.⁶³

The key issues to consider in drafting an arbitration agreement are: (1) the method of selecting the arbitrator;⁶⁴ (2) the issues to be submitted to the arbitrator; (3) the timetable, if any, governing when the arbitration panel must reach a decision; (4) whether the arbitration panel must set forth its reasoning in an opinion; (5) the inclusion of any procedural rules, or the adoption of standard procedures set forth by a neutral organization such as the American Arbitration Association; and (6) any limitations on the arbitrator's remedial authority.

Timothy E. Travers, Annotation, *Arbitrator's Power to Award Punitive Damages*, 83 A.L.R.3d 1037, 1040 (1978).

In reviewing an arbitration, courts will employ a deferential standard of review. See *Anderman/Smith Operating Co. v. Tennessee Gas Pipeline Co.*, 918 F.2d 1215, 1217-18 (5th Cir. 1990) (affirming district court's confirmation of arbitrator's decision that required pipeline, in order to exercise market-out right, to demonstrate by a preponderance of the evidence that the existing price was so high that the pipeline could not remain competitive in its end use markets), *cert. denied*, 111 S. Ct. 2799 (1991).

61. See generally James K. Brown & John P. Melick, *The Arbitration Alternative for Various Coal, Oil, and Gas Non-Labor Disputes*, 5 E. MIN. L. INST. § 1.01 (1984); Jay F. Lapin & Roger J. Patterson, *Alternative Dispute Resolution: New Strategies for Litigation and Settlement of Legal Claims*, 40 INST. ON OIL & GAS L. & TAX'N § 6.01 (1989); Bruce S. Marks, *Commercial Conflict Management and Alternative Dispute Resolution in the Oil and Gas Industry*, 41 INST. ON OIL & GAS L. & TAX'N § 9.01 (1990); D. Alan Rudlin & Michael R. Shebelskie, *The Myths and Realities of Alternative Dispute Resolution Techniques*, 9 E. MIN. L. INST. § 2.01 (1988); William Pannill & Katherine L. Butler, *How to Survive Arbitration Under the Typical Gas Contract* (paper presented to ABA Workshop on Take-or-Pay and Ratable Take Issues, July 1986, on file with the *Tulsa Law Journal*).

62. See, e.g., *Falcon Petroleum Co. v. Panhandle E. Pipe Line Co.*, 787 P.2d 1297 (Okla. Ct. App. 1990) (arbitration clause enforced in part in take-or-pay dispute); *Transwestern Pipeline Co. v. Horizon Oil & Gas Co.*, 809 S.W.2d 589 (Tex. App.—Dallas 1991, writ dismissed w.o.j.) (holding arbitration clause in original contract governed disputes under settlement agreement where settlement agreement only modified but did not extinguish original contract); *Mewbourne Oil Co. v. Blackburn*, 793 S.W.2d 735 (Tex. App.—Amarillo 1990, mand. overr.) (enforcing arbitration procedure); *Valero Energy Corp. v. Wagner & Brown, II*, 777 S.W.2d 564 (Tex. App.—El Paso 1989, writ denied) (subjecting contract, including tort claim, to arbitration).

63. See, e.g., *Anderman/Smith Operating Co. v. Tennessee Gas Pipeline Co.*, No. J89-1066(W) (S.D. Miss. May 30, 1990), *aff'd*, 918 F.2d 1215 (5th Cir. 1990) (providing that any price change desired by the pipeline must first be approved by the arbitration panel), *cert. denied*, 111 S. Ct. 2799 (1991).

64. Contract provisions typically provide for a panel of three arbitrators: one selected by the producer, one by the pipeline, and the third by the selected arbitrators (if possible). See *supra* note 58 and accompanying text. Thus, the third, "independent" arbitrator often makes the ultimate decision. This three arbitrator procedure is criticized in MARTIN DOMKE, *DOMKE ON COMMERCIAL ARBITRATION* § 20.03 (rev. ed. 1984 & Supp. 1990).

D. *Forum Selection Clause*

Although not traditionally included in gas contracts, a forum selection clause may benefit parties to the gas contract. Experience indicates that a forum selection clause would reduce the rush to obtain a favorable forum that frequently occurs in gas contract disputes.⁶⁵ Without the clause, the producer who writes a formal demand letter to the pipeline attempting to negotiate a settlement runs the risk that the pipeline might respond by filing suit for a declaratory judgment in the pipeline's forum of choice. The forum can be critical in any action, and particularly in a take-or-pay or gas contract action. For example, a producer would not want to prosecute a take-or-pay action against: Northern Natural Gas Company in Omaha, Nebraska; any pipeline in Minneapolis or Chicago in the dead of winter; or a pipeline in a forum in which a determination would be five years away. Thus, careful use of a forum selection clause might obviate a rush to litigation and give lead time for negotiation and possible settlement.

Although forum selection clauses have been affirmed as valid by the United States Supreme Court,⁶⁶ there is a split of authority as to their enforceability in state court.⁶⁷ The general rule is that if the parties are commercial entities, no indication of adhesion or oppression exists, and the forum selected has a reasonable connection with the dispute, the

65. See, e.g., *ANR Pipeline Co. v. Conoco, Inc.*, 646 F. Supp. 439 (W.D. Mich. 1986) (prohibiting producer from bringing duplicate litigation in other forum or removing action to federal court); see also *Williams Natural Gas Co. v. Amoco Prod. Co.*, No. 11040, 1991 WL 58387 (Del. Ch. Apr. 16, 1991) (the pipeline company invoked Delaware jurisdiction to construe Kansas contracts). Of course, there was no reason why the producer should not have played the same game. See, e.g., *Kaiser-Francis Oil Co. v. ANR Pipeline Co.*, No. CJ-87-00428 (Okla. Dist. Ct. Tulsa County Jan. 27, 1987) (issuing temporary restraining order that prohibited pipeline from filing suit on contracts except in the pending action).

In the absence of a forum selection clause, the party filing a preemptive attack must carefully consider the venue. A miscalculation as to the "best" forum might not be correctable. See, e.g., *BHP Petroleum Co. v. Millard*, 800 S.W.2d 838 (Tex. 1990). In *Millard*, the producer filed suit in a Texas district court forum. The pipeline subsequently filed a declaratory judgment counterclaim. The producer then dismissed its claim. Later, the producer unsuccessfully moved to dismiss the counterclaim and the Texas Supreme Court denied a writ of certiorari to review the lower court's decision. *Id.*

66. *Carnival Cruise Lines, Inc. v. Shute*, 111 S. Ct. 1522 (1991); *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972).

67. See 17A AM. JUR. 2D *Contracts* § 266 (1991) (discussing enforceability); Richard D. Freer, *Erie's Mid-Life Crisis*, 63 TUL. L. REV. 1087, 1096 n.31 (1989) (listing thirteen states which reject forum selection clauses); Leandra Lederman, Note, *Viva Zapata! Toward a Rational System of Forum-Selection Clause Enforcement in Diversity Cases*, 66 N.Y.U. L. Rev. 422 (1991); Francis M. Dougherty, Annotation, *Validity of Contractual Provision Limiting Place or Court in Which Action May be Brought*, 31 A.L.R.4TH 404 (1984) (discussing federal and state cases construing forum selection clauses).

clause will be enforced.⁶⁸

E. *Quality Clause*

The quality clause, contained in every gas contract, specifies minimum standards of gas the seller must deliver under the contract before the buyer is obligated to take the gas. The standards, set by the pipeline, include: water specifications; minimum and possibly maximum British thermal units ("Btu") levels; and impurity levels for sulphur compounds, oxygen, nitrogen, carbon dioxide and other chemical ingredients.

In past litigation, pipelines have used minute quality deficiencies that would not have an adverse safety impact to excuse their performance of the gas contract. For example, if the Btu requirement was 1000 and the test on a well indicated 999, four years later a pipeline might assert a quality defect as an excuse for not taking the gas. In the past, pipelines had mixed success when utilizing this defense.

Most quality clauses required the pipeline to give notice to the producer of a quality defect so the producer could attempt to cure the defect. Even if notice was not specifically required in the contract, courts construed the quality provision to include an implied notice obligation. Thus, the pipeline's failure to give sufficient notice precluded the defense.⁶⁹ Similarly, courts were skeptical about pipeline assertions of quality defects when pipelines continued to take gas from sellers with which

68. See, e.g., *Seattle-First Nat'l Bank v. Manges*, 900 F.2d 795, 800 (5th Cir. 1990) (affirming injunction enforcing forum selection clause); *Knight Medical, Inc. v. Nihon Kohden Am., Inc.*, 765 F. Supp. 291 (M.D.N.C. 1991) (enforcing forum choice provision); *Appell v. George Philip & Son, Ltd.*, 760 F. Supp. 167 (D. Nev. 1991) (holding that forum selection clause was enforceable). *But cf.* *Carefree Vacations, Inc. v. Brunner*, 615 F. Supp. 211, 214 (W.D. Tenn. 1985) (holding that choice of Texas as forum was unenforceable because Texas had no contacts with the contract or with the parties); *Eads v. Woodmen of the World Life Ins. Soc'y*, 785 P.2d 328 (Okla. Ct. App. 1989) (stating general rule, but finding forum clause under particular facts of case unenforceable).

In addition, the parties should consider inserting a choice of law provision that stipulates which state law will govern the interpretation, construction and enforcement of the contract. Oklahoma has traditionally enforced such clauses if the jurisdiction selected has some connection with the contract or the parties. See, e.g., *Roush v. National Old Line Ins. Co.*, 453 F. Supp. 247 (W.D. Okla. 1978); *National Life & Accident Ins. Co. v. Whitlock*, 180 P.2d 647 (Okla. 1946), and if such clause's enforcement would not violate Oklahoma public policy, *Klein v. Keller*, 141 P. 1117 (Okla. 1914). UCC § 1-105 explicitly permits choice of law provisions.

69. See Report and Recommendation of U.S. Magistrate at 9-10, *Prospective Inv. & Trading Co. v. Producer's Gas Co.*, No. 86-C-986-C (N.D. Okla. Dec. 20, 1988) (adopted by court July 7, 1989); *Kaiser-Francis Oil Co. v. Producer's Gas Co.*, No. 83-C-400-B (N.D. Okla. June 19, 1985) (noting that implicit in the quality clause is that purchaser must provide notice to seller of failure of quality so that seller can have an opportunity to cure), *aff'd*, 870 F.2d 563 (10th Cir. 1989); *Southport Exploration, Inc. v. Producer's Gas Co.*, No. 83-C-550-B, slip op. at 7 (N.D. Okla. June 6, 1984) (holding that buyer waived right to object to quality because it took the gas and failed to give notice of defect to the seller). For a general discussion and samples of quality clauses in gas contracts, see Gilliam, *supra* note 15, § 6.05; Gregg, *supra* note 58, at 125, 177-79; Ben R. Howell, *Gas*

they had entered into a settlement.⁷⁰ The lack of a curative provision in the quality clause should not deprive the producer of a right to cure because the right to cure is found in the UCC.⁷¹

Past disputes suggest that the producer and the buyer carefully consider the quality provision during negotiation. The contract should require the buyer (pipeline) to give precise and specific notice (preferably written) of any defects in the gas within a certain period of time and give the producer the right to timely cure defects. The producer, in the course of its contract maintenance and administration, should carefully monitor the quality of the gas to assure it meets the specifications set forth in the contract.

F. *Billing or Audit Clause*

Many gas contracts contain what is known as a billing or audit clause. A typical billing clause follows:

As soon as practicable following the end of each accounting month during the term hereof, buyer shall furnish to seller a statement of all gas delivered hereunder by seller during the preceding accounting month; and buyer shall pay seller by the 20th day of each calendar month for all gas delivered to buyer hereunder during the preceding accounting month in accordance with each such statement; provided that each party shall have the right, at reasonable hours, to examine the books and records of the other party to the extent necessary to verify the accuracy of any statement, payment or calculation relating to the gas delivered hereunder. If any such examination reveals any inaccuracy, the necessary adjustment and such payment statements and payments shall be promptly made, provided that no adjustment for any statement or payment shall be made after a lapse of two (2) years from the date hereof unless challenged prior thereto.

In past gas contract litigation, some pipelines argued that this clause was a contractual limitation period, thus shortening the normal four or

Purchase Contracts, 4 INST. ON OIL & GAS L. & TAX'N 151, 163-64 (1953); John R. Rebman, *Drafting Natural Gas Sales Contracts Under Conditions of Gas Supply Shortage—The Producer-Seller's View*, 19 ROCKY MTN. MIN. L. INST. 205, 230-32 (1974).

70. *See* Kaiser-Francis Oil Co. v. Producer's Gas Co., 870 F.2d 563, 566-68 (10th Cir. 1989).

71. Under UCC § 2-508, a seller, upon rejection by the buyer for a non-conforming tender, has the right to effect a cure. *See* 3 ANDERSON, *supra* note 20, § 2-508:1 to :17; 2 HAWKLAND, *supra* note 20, § 2-508:01 to :07; William H. Lawrence, *Cure Under Article 2 of the Uniform Commercial Code: Practices and Prescriptions*, 21 UCC L.J. 138 (1988); Michael A. Schmitt, *The Seller's Right to Cure Non-Conforming Tenders—If at First You Don't Succeed, Try to Try Again*, 87 COM. L.J. 283 (1982). Seasonable notice of rejection is required by UCC § 2-602. *See* 4 ANDERSON, *supra* note 20, § 2-602:4; 3 HAWKLAND, *supra* note 20, § 2-602:02; Joe D. Dillsaver, *Notice in Article 2 of the Uniform Commercial Code*, 22 UCC L.J. 66, 77-79 (1989).

five year statutory period for bringing a breach of contract action. Pipelines sought to minimize their damages by shortening the period of time for which the producer could recover for failure to take or pay for gas.⁷² Although the UCC permits contracts to reduce the otherwise applicable statute of limitation period,⁷³ courts disfavor and strictly construe such provisions against the party invoking the shortened period.⁷⁴ The parties must expressly state that such a provision was intended to be a contractual limitation.⁷⁵ Most of the audit provisions failed to reflect that specific intent. One court noted that "[t]he fact that claims for discrepancies must be presented within two years does not indicate any clear intention to shorten the statutory limitation period in the event of a suit based upon a breach of agreement."⁷⁶

Experience shows that a billing and audit clause, boilerplate in the past, must be carefully analyzed in the future. If such a clause is inserted in the contract, the parties should state whether it is intended as a contractual limitation. In any event, the producer should carefully monitor its accounting department and make sure that amounts paid for, and gas taken, every month does in fact satisfy the contractual provisions on payment and pricing. Should a dispute arise, the producer should quickly initiate conversation with the buyer.

72. See, e.g., *Benson Mineral Group, Inc. v. Enron Gas Processing Co.*, No. 89-1186-K (D. Kan. Jan. 14, 1991); *Kansas Petroleum, Inc. v. Colorado Interstate Gas Co.*, 710 F. Supp. 758 (D. Kan. 1989); *Conoco, Inc. v. Tenneco, Inc.*, 524 So. 2d 1305 (La. Ct. App.), cert. denied, 525 So. 2d 1048 (La. 1988). Typically, an audit or billing clause requires a challenge within the specified period, not the filing of a suit. This requirement suggests that such a clause is not a contractual limitation. See *Exxon Corp. v. Crosby-Mississippi Resources, Ltd.*, 775 F. Supp. 969, 975-76 (S.D. Miss. 1991) (finding that time limitation in billing clause required a challenge be raised within the period, not the filing of a suit). For a brief discussion of such clauses and a sample billing clause that does not contain a time period, see *Gregg*, *supra* note 58, at 141, 189.

73. U.C.C. § 2-725(1), 1B U.L.A. 587 (1989). See 5 ANDERSON, *supra* note 20, §§ 2-725:105, :107.

74. *In re Penn Cent. Transp. Co.*, 391 F. Supp. 1404, 1407 (E.D. Pa. 1975); *Prior Lake State Bank v. National Sur. Corp.*, 80 N.W.2d 612, 616 (Minn. 1957); see *Schafer v. Buckeye Union Ins. Co.*, 381 N.E.2d 519, 522-23 (Ind. Ct. App. 1978).

75. *Ontario Hydro v. Zallea Sys., Inc.*, 569 F. Supp. 1261, 1265 (D. Del. 1983); see, e.g., *Welch v. Mitchell*, 351 So. 2d 911, 916-17 (Ala. Civ. App. 1977) (holding express warranty expired in twelve months did not limit the time for filing suit the same period); *Lieb v. Milne*, 625 P.2d 1233, 1237 (N.M. Ct. App. 1980) (fixed time for duration of seller's warranty not a contractual limitation, and did not require that suit be brought within the warranty period).

76. *Oil & Gas Ventures—First 1958 Fund, Ltd. v. Kung*, 250 F. Supp. 744, 753 (S.D.N.Y. 1966). Producers should not overlook state constitutional or statutory provisions limiting the effectiveness of notice and/or contractual limitation clauses. See, e.g., OKLA. CONST. art. XXIII, § 9; OKLA. STAT. tit. 15, § 216 (1981).

G. Pricing Clause

All gas contracts contain pricing provisions that set forth the price which the buyer must remit to the producer for gas taken. Such pricing clauses have been the subject of litigation disputes,⁷⁷ particularly when federal deregulation led to ambiguity in the price. A drafter of a pricing clause should create a pricing mechanism that anticipates events in the future that might create an uncertainty in the pricing such as governmental regulation. The drafter should normally avoid gaps in the pricing structure (occurrences which would lead to no price or an ambiguous price). If a gap is intended, the drafter should carefully consider the impact of the gap in the event a dispute arises. For instance, the UCC has numerous gap fillers,⁷⁸ including one for a reasonable price in the event a gap in the price term exists.⁷⁹ Usually, the parties would be in a more certain position if they negotiate a pricing structure that would cover all possible situations.

77. See, e.g., *Northwest Cent. Pipeline Corp. v. JER Partnership*, 943 F.2d 1219 (10th Cir. 1991); *Southern Natural Gas Co. v. Pursue Energy*, 781 F.2d 1079 (5th Cir. 1986); *Walsh Bros. v. Celeron Corp.*, 510 So. 2d 1282 (La. Ct. App.), cert. denied, 513 So. 2d 293 (La. 1987); *Vince Allen & Assocs., Inc. v. Delhi Gas Pipeline Corp.*, 788 P.2d 414 (Okla. Ct. App. 1989); *Houston Oil & Minerals Corp. v. Enserch Corp.*, 732 S.W.2d 419 (Tex. App.—Houston [14th Dist.] 1987, writ ref'd n.r.e.); cf. *Grynberg v. Rocky Mountain Natural Gas*, 809 P.2d 1091, 1094 (Colo. Ct. App. 1991) (holding that although take-or-pay contract is an alternative performance contract, producer cannot calculate prices based on "pay" alternative so as to justify [higher] NGPA § 102 rates because pipeline was able to perform "take" alternative and thus [lower] NGPA § 104 rates would be applicable).

For a discussion of pricing clauses, see David Crump, *Natural Gas Price Escalation Clauses: A Legal and Economic Analysis*, 70 MINN. L. REV. 61 (1985); Al H. Ringleb et al., *Natural Gas Contract Periodic Price Redeterminations: A Statistical Methodology with Preliminary Empirical Results*, 10 ENERGY L.J. 81 (1989). For a collection of cases, see 4 SUMMERS, *supra* note 15, § 761.

78. See, e.g., U.C.C. §§ 2-305 (price), 2-306 (quantity), 2-308 (place of delivery), 2-309 (time of delivery), 2-503 (tender by seller), 2-509 (risk of loss), 2-511 (tender by buyer), 2-513 (buyer's inspection). See generally 1 WHITE & SUMMERS, *supra* note 19, §§ 3-5 to -9; William D. Hawkland, *Sales Contract Terms Under the UCC*, 17 UCC L.J. 195 (1985).

79. U.C.C. § 2-305. See 2 ANDERSON, *supra* note 20, § 2-305:1 to :23; 2 HAWKLAND, *supra* note 20, § 2-305:01 to :05; Timothy E. Travers, Annotation, *Construction and Application of UCC § 2-305 Dealing With Open Price Term Contracts*, 91 A.L.R.3d 1237 (1979). For an application of § 2-305 to an analogous situation, see *North Cent. Airlines, Inc. v. Continental Oil Co.*, 574 F.2d 582 (D.C. Cir. 1978) (price mechanism set forth in contract made inoperable by enactment of federal price regulation of oil and introduction of two-tier pricing system; court used § 2-305 to provide a price). A provision designed to avoid a gap upon deregulation follows:

For gas produced, sold and delivered hereunder, or any portion thereof, which the United States Congress, FERC, or any other governmental authority having jurisdiction in the premises, ceases or has already ceased to have jurisdiction or exercise control over rates that may be lawfully charged and collected (hereinafter referred to as "deregulated gas"):

The price of \$6.00 per MMBtu effective January 1, 1982, which price shall be increased on the first day of each month thereafter by an amount equal to one half of one per cent (.005) above the price in effect during the previous month.

For a discussion of deregulation clauses, see Turner, *supra* note 10.

H. *Dedication Clause*

A dedication clause, included in most gas purchase contracts, specifies which wells or gas reserves (by property or legal description) are dedicated to the purchaser.⁸⁰ Ambiguous dedication clauses and the parties' inconsistent course of performance have resulted in disputes over whether specific wells were covered by the particular contract.⁸¹ In the future, producers may abandon the practice of dedicating a particular well to the contract in favor of simply agreeing to satisfy supply commitments from any available source.

I. *Market-Out Clause*

Thoughtful purchasers included provisions in their contracts that gave them rights to reduce the applicable price or to terminate the contract.⁸² Such provisions, known as market-out clauses, should carefully define the rights, standards upon which the rights may be exercised (subjective or objective), the range of permissible pricing modification, and the frequency with which such rights may be exercised.⁸³ A seller may also insist upon the right in the contract to upward adjustments of price or to terminate the agreement in instances when a seller's market exists.⁸⁴

J. *Ratchet Clause*

A ratchet clause grants a buyer the right to reduce the daily contract quantity upon failure of the producer to deliver the amount of gas requested by the pipeline.⁸⁵ The issue which frequently resolved ratchet

80. 4 HOWARD R. WILLIAMS, OIL AND GAS LAW § 724.6 (1991); Howell, *supra* note 69, at 155-58 (1952); J. Clayton La Grone, *Natural Gas Contracting in the '80s*, 32 INST. ON OIL & GAS L. & TAX'N 25, 29-32 (1981).

81. See, e.g., Benson Mineral Group, Inc. v. Enron Gas Processing Co., No. 89-1186-K (D. Kan. Jan. 14, 1991); Shawmar Oil Co., Inc. v. Williams Natural Gas Co., No. 89-4081-S, 1990 WL 186286 (D. Kan. Oct. 9, 1990).

82. See Johnson, *supra* note 15, at 104-05; Turner, *supra* note 10, at 521-22.

83. For examples of such clauses, see *Anderman/Smith Operating Co. v. Tennessee Gas Pipeline Co.*, 918 F.2d 1215, 1218-19 (5th Cir. 1990) (affirming narrow construction given market-out clause by arbitration panel), *cert. denied*, 111 S. Ct. 2799 (1991); *American Exploration Co. v. Columbia Gas Transmission Corp.*, 779 F.2d 310, 313-14 (6th Cir. 1985) (affirming denial of preliminary injunction request by producer, noting that contract provision permitted buyer to discontinue buying gas "for such length of time as in its judgement it is deemed expedient"); and *Kennedy & Mitchell, Inc. v. Anadarko Prod. Co.*, 754 P.2d 803, 807 (Kan. 1988) (holding gas contract market-out provision gave buyer unilateral right to determine when the contract price was unacceptable and to propose a lower price). See also Turner, *supra* note 10, at 519-22.

84. Many producers negotiated price escalation clauses into their contracts. See *Crump*, *supra* note 77; Johnson, *supra* note 15, at 94-108; Ringleb et al., *supra* note 77; Turner, *supra* note 10, at 515-19.

85. One commonly used provision follows:

clause⁸⁶ disputes concerned notice. Some clauses required notice to the producer of the buyer's election or option to reduce the daily contract quantity;⁸⁷ others did not.⁸⁸ The notice obligation often defeated the defense because the pipeline's use of the ratchet clause as a defense to an accrued take-or-pay claim was largely one of hindsight.⁸⁹ Ratchet clauses commonly provided a mechanism by which the producer could restore the previous daily contract quantity level. Thus, the clause was mostly effective in instances where no notice was required. With notice, the producer could be expected to undertake curative measures to restore the daily contract quantity.⁹⁰ A notice requirement should be explicitly

In the event seller fails to deliver the volumes requested by Buyer up to one hundred eleven (111) percent of the applicable daily contract quantity for five (5) consecutive days, then at Buyer's option, commencing with the first day of the month following the end of the fifth day of such failure to deliver and continuing thereafter until adjusted as hereinafter provided, the applicable daily contract quantity may be reduced to ninety (90) percent of the average daily volumes delivered during such five day period.

Atlantic Richfield Co. v. ANR Pipeline Co., 768 S.W.2d 777, 779 (Tex. App.—Houston [14th Dist.] 1989, no writ). Such clauses not only reduced take-or-pay obligations but also created the serious potential for overtake credits in favor of the pipeline, which could offset undertakes in other days of the year.

86. The phrase "ratchet clause" was coined because the provision enabled the pipeline to "ratchet" down its daily contract quantity obligation. *See Pyro Energy Corp. v. Kansas Power & Light Co.*, No. 62765, 1989 WL 69457 (Kan. Ct. App. June 23, 1989).

87. For example, the clause in *supra* note 83, which provides "at Buyer's option," implies notice. Furthermore, the inclusion of a curative provision also pointed to a notice requirement. How could a producer exercise its curative rights without notice of the pipeline's exercise of its ratchet down rights? *Cf. Kaiser-Francis Oil Co. v. Producer's Gas Co.*, No. 83-C-400-B, 1985 WL 9668 (N.D. Okla. June 19, 1985) (holding that including a curative provision in the quality clause implies an obligation on the pipeline to give notice of its exercise of ratchet down rights), *aff'd*, 870 F.2d 563 (10th Cir. 1989). In addition, a pipeline seeking to invoke a ratchet clause should be required, through contemporaneous documentation, to establish that the pipeline acted to reduce the daily contract quality.

88. "In the event Buyer requests such quantities on any day or days and Seller is unable, unwilling or fails for any reason to deliver such quantities, the Seller's Delivery Capacity shall be reduced to such quantities as Seller is able, willing or does not fail to deliver . . ." *Pyro Energy Corp.*, No. 62765, 1989 WL 69457, at *4. Even if a notice provision is not included in the ratchet clause, notice may still be required under the auspices of good faith. *See U.C.C. § 2-103*, 1 U.L.A. 185 (1989).

89. *See Dycos Petroleum Corp. v. ANR Pipeline Co.*, No. 86-C-1097-E, slip op. at 12-13 (N.D. Okla. Aug. 29, 1990) (holding that term "election" in clause defeated pipeline's claim that daily contract quantity should automatically reduce and construing the clause to require ANR to make an affirmative election); *cf. Atlantic Richfield Co. v. ANR Pipeline Co.*, 768 S.W.2d 777, 785 (Tex. App.—Houston [14th Dist.] 1989, no writ) (Brown, C.J., concurring) ("I would also hold the 'option' provision does not apply as a matter of law in that it is 'at Buyer's option' and hence is invoked only by some form of notice which was not given."). *But cf. Pyro Energy Corp.*, No. 62765, 1989 WL 69457 (holding that force majeure clause, in conjunction with ratchet clause, justified jury's verdict in favor of pipeline).

90. An example of a ratchet clause follows:

In the event the daily contract quantity is adjusted downward as provided in this Section 4, then Seller shall have the opportunity to restore all or a portion of such daily contract quantity by written request to Buyer to conduct a deliverability test; provided, however, if as a result of such test the daily contract quantity is not restored to the daily

written by future drafters into provisions of future contracts along with a reasonable mechanism to permit the producer to restore the deliverable level.

K. *Regulations Applicable Clause*

The regulations applicable clause provides that a contract is subject to governmental laws and regulations. Ordinarily, a regulations applicable clause should not be incorporated in the contract because inclusion of the clause may be interpreted by the courts as more than a meaningless boilerplate provision. In essence, the clause is meaningless because all contracts are clearly subject to governing law.⁹¹ To avoid rendering a regulations applicable clause meaningless, courts may construe it as meaning something the parties had not intended.⁹² For example, pipelines have attempted to broaden the scope of a force majeure provision with the regulations applicable clause.

VII. CONCLUSION

The contract drafting lessons of the past, learned the hard way by many participants, should be valuable for the future. Past take-or-pay wars illustrate the necessity for careful consideration of even the most boilerplate of provisions. However, drafters should not rely on the past to repeat itself. Parties must expect the unexpected when drafting a long-term contract in an area of overlapping federal, international and economic considerations. The parties must seek to accommodate both their common and divergent interests in a form flexible enough to withstand the vagaries of time.

contract quantity in effect prior to such downward adjustment, Seller shall not be permitted for a period of ninety (90) days following the completion of such test to request Buyer to conduct a subsequent test. It is further provided that upon receipt of notice from Seller that the inability to deliver gas well gas has been remedied, Buyer may, in lieu of conducting such test, notify Seller that commencing with the first day of the month following receipt of said notice from Seller, the downward adjustment in the daily contract quantity as provided in this Section 4 shall no longer be effective.

91. *Buckles v. Wil-Mc Oil Corp.* 585 P.2d 1360, 1362 (Okla. 1978); 17 AM. JUR. 2D *Contracts* §§ 381, 382 (1991).

92. Courts will presume that contractual language is not meaningless. Thus, considering the purpose of the contract as a whole, a court will attempt to give meaning to every aspect of the instrument. OKLA. STAT. tit. 15, § 159 (1981). The primary goal in giving meaning to ambiguous contractual language is to facilitate performance. 17 AM. JUR. 2D *Contracts* §§ 386, 387. The danger lies in whether or not the court will construe the regulations applicable clause in a manner intended by the parties. *See, e.g., Dycos Petroleum Corp. v. El Paso Natural Gas Co.*, No. 86-C-897-E (N.D. Okla. Nov. 1, 1988) (rejecting contention that regulations applicable clause broadened force majeure provision to encompass regulation affecting market prices). The basic lesson is to avoid inserting provisions that serve no identifiable purpose.