Chapter 6
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Gas Purchase Contracts Today: A Whole New Ballgame

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Synopsis

§ 6.01. Overview.

The sweeping changes which occurred in the gas industry have resulted in corresponding changes to gas purchase contracts. Before Federal Energy Regulatory Commission (FERC) Order 636, gas purchase contracts generally involved a long-term relationship between the producer and a gas pipeline. Because the parties contemplated a long marriage, the parties carefully investigated each other and the contract reflected that care in detailed representations and warranties. The price of the gas was not a major consideration because it was tied to maximum lawful prices under the Natural Gas Policy Act.[2] The contractual relationship between the producer and the gas pipeline was heavily regulated by government. The gas purchased by the pipeline was then transmitted to the end-user via a local distribution company (LDC). That relationship was also heavily regulated and not subject to much negotiation.

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2 15 U.S.C. §§ 3301-3432 (1988).

Order 636 changed the nature of gas purchase contracts drastically. The long-term marriages between producers and pipelines have been replaced by short-term relationships between producers, marketers and end-users, with the pipelines providing transportation. Now, marketers buy gas from producers and sell it to end-users.

The marketer is the buyer in the gas purchase contract with the producer, and becomes the seller in the gas purchase contract with the end-user. Everything is negotiable; very little is regulated. Price is the paramount concern. Because the laws of supply and demand have displaced regulation, contracts are shorter in term — measured in months rather than years.

The realities of buying and selling gas in a competitive, price-sensitive market have made it difficult to document gas purchase agreements in the detailed fashion as before Order 636. There are more buyers and sellers, more agreements, and the agreements are made faster.

These factors make it impossible to document agreements as carefully as in the past. However, it is more important than ever to document the critical terms of the parties' agreement. In any market where goods are basically fungible and prices fluctuate quickly, reliance on oral agreements or hastily executed written agreements will eventually lead to litigation.

This chapter will look at how the changes in the industry have led to changes in gas purchase contracts, and to the use of form or model contracts to fulfill the requirement of a written contract. Finally, the chapter will also predict likely areas of litigation under the new order.

§ 6.02. Gas Purchase Contracts Before FERC Order 636.

Over the past 20 years, the natural gas industry has shifted from a natural monopoly governed by federal regulation to a commodity market governed by supply and demand. In order to understand the legal issues presented by gas purchase contracts, it is necessary to understand the structure of the industry and the economic motivations of the various participants.

Before deregulation, gas producers sold their product to interstate gas pipeline companies. The pipelines in turn transported the gas to local