E&MLF

Chapter 14

Cite as 16 *E. Min. L. Inst.* ch. 14 (1997)

Measuring Producers' Forward Damages for Breach of Long-Term Gas Supply Contracts

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Synopsis

§ 14.01. Introduction.

Into the 1980s, long-term gas supply contracts were the rule in the gas industry. Utilities providing gas to the public bound themselves to such contracts, and to "minimum take" clauses therein, to purchase their gas needs from pipelines. Pipelines in turn bought gas from producers under long-term contracts with "take-or-pay" clauses. Through the 1980s, as gas supplies decreased and gas prices soared, the Federal Energy Regulatory Commission (FERC) began issuing orders excusing utilities from their "minimum take" obligations. But FERC did not in turn excuse the pipelines from their "take-or-pay" obligations to producers. Thus, in recent years pipelines have faced the anathema of commercial middlemen: they remain bound under long-term contracts to purchase from their suppliers — the producers — and yet their customers, the utilities, no longer are bound to them.[1] The courts in turn have generally refused to

[1] *See* Medina, "The Take-or-Pay Wars: A Cautionary Analysis for the Future," *Natural Gas Marketing and Transportation*, Paper No. 10, p. 10-11 (Rocky Mt. Min. L. Fdn. 1991).

excuse pipelines from their obligations to producers, usually supporting their decisions with the reasoning that the "take-or-pay" clause in the long-term contract with the producer allocates all market risk to the pipeline.[2]

Although some pipelines have been able to renegotiate their contracts with producers, others have been forced into litigation and still others have been forced into bankruptcy. The issue for discussion is how to measure the breach of a contract claim of the producer against the pipeline. In principle, it should make no difference whether that claim arises from litigation, in a suit by the producer against the pipeline, or in bankruptcy. The bankruptcy of a major pipeline, however, may involve the quantification of claims for repudiation of hundreds, even thousands, of gas supply contracts involving a myriad of different pricing and other relevant provisions. A bankruptcy court thus may quite properly decide to exercise its equity powers to bend the rules of law for expediency purposes. This chapter will treat the propriety of bankruptcy expediency only in passing, and will focus primarily on how the Uniform Commercial Code (UCC or Code) requires that a producer's claim be measured.

§ 14.02. Variances Among Pricing Provisions.

For present purposes, assume that the buyer, a pipeline, has breached a "take-or-pay" contract with the seller, a producer, and that the contract has many years left to run. Gas contracts commonly have sophisticated and complex pricing provisions.[3] As discussed below, the Code makes the contract price of the breached contract an important component in measuring the value of the seller/producer's claim; *i.e.*, the damages suffered by the producer. This chapter will eschew complexities and variations in gas pricing provisions and will assume that the producer's claim falls within one of three categories of provisions: (a) a fixed price

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2 *See, e.g.*, Universal Resources Corp. v. Panhandle E. Pipe Line Co., 813 F.2d 77 (5th Cir. 1987).

3 *See* Caggiano, "Understanding Natural Gas Contracts," 38 *Oil & Gas Tax Q.* 267 (1989).