

CHAPTER 23

Measuring Seller's Damages for Breach of Long-Term Gas Purchase Contracts

Gregory M. Travalio⁽¹⁾

Professor of Law

Ohio State University College of Law

Columbus, Ohio

Synopsis

§ 23.01. Introduction.

§ 23.02. Application of the Uniform Commercial Code to Gas Purchase Contracts.

§ 23.03. Seller's Remedies Under the Code.

[1]--Section 2-706: The Right of Resale.

[2]--Section 2-708: The Contract/Market Difference v. Lost Profits.

[3]--Determination of Market Damages.

[4]--Action for the Price.

[5]--Specific Performance or Periodic Payments.

§ 23.04. Conclusion.

§ 23.01. Introduction.

The purpose of this Chapter is to examine some of the problems confronting courts faced with a buyer's breach of a long-term contract for the purchase of natural gas. As we will see, most of the problems discussed are not unique to long-term gas purchase contracts. However, because of the nature of the market and the unique provisions of many gas purchase contracts, some of the difficulties are particularly intractable in this context.

The issue of seller's damages arises, of course, whenever there is a breach by a buyer of a long-term gas purchase contract. It is especially timely, however, in view of the Chapter 11 Bankruptcy of Columbia Gas Transmission Corp., and the impact of the Federal Energy Regulatory Commission's (FERC) Order 636.⁽²⁾ It can also arise in other contexts such as litigation over the amount of royalties payable by a producer to the owner of the mineral rights and the valuation of producing property.

This Chapter begins with a short discussion of the application of the Uniform Commercial Code (UCC or

Code) to gas purchase contracts. It then discusses the available remedy provisions of the Code, focusing in greater detail on a few significant problems faced by courts in applying these provisions to long-term gas supply contracts. Finally, it briefly explores alternatives to traditional damage recoveries.

§ 23.02. Application of the Uniform Commercial Code to Gas Purchase Contracts.

Section 2-107(1) of the Code states: "A contract for the sale of minerals or the like (*including oil and gas*)...to be removed from realty is a contract for the sale of goods within this Chapter if they are to be severed by the seller . . ."(3)

The original draft of this Section did not include the parenthetical "(including oil and gas)." In 1972, however, the Section was amended to include the parenthetical and the cases since then have uniformly applied the Code to contracts for the sale of oil.(4)

§ 23.03. Seller's Remedies Under the Code.

The seller's remedies under the UCC are catalogued in Section 2-703.(5) While these remedies are applicable in a number of potential breach scenarios,(6) this Chapter is primarily concerned with the repudiation by a buyer before full performance of its contractual obligations to purchase natural gas. Assuming that the repudiation constitutes a breach of the whole contract,(7) the seller can cancel the contract and is entitled to the remedies enumerated in Section 2-703.(8)

There are four damage remedies in Section 2-703, although they reside in only three sections of the Code.(9) Each of them is potentially applicable in the context of a repudiation of a long-term gas supply contract; each presents its own particular problems. It should be kept in mind throughout that the intent of the Code's remedial provisions is to put the seller in the same position as if the contract had been performed.(10) The remainder of the Chapter will consider each of these measures in detail.

[1]--Section 2-706: The Right of Resale.

The Code provides both an aggrieved seller and an aggrieved buyer a right to measure damages by a substitute transaction, a right that was unavailable at common law.(11) An aggrieved buyer may purchase substitute goods and recover the difference between the contract price and the price of substitute goods so long as the purchase was made in a commercially reasonable manner.(12) The seller's analog is found in Section 2-706, which permits a seller to resell the goods that were the subject of a contract repudiated by the buyer and to recover the difference between the contract price and the resale price.(13) If the resale is made in good faith and in a commercially reasonable manner, the aggrieved seller can recover the difference between the resale price and the contract price.

As a general matter, this Section has posed few problems in application.(14) Courts need to remember that, to the extent the seller saves expenses on the resale contract, perhaps because transportation expenses are less, these savings should be deducted from the recovery. In addition, Section 2-706 provides for recovery of both the reasonable search costs of finding a new buyer and the cost of retaining the goods for a reasonable time until delivery is made under a resale contract.(15)

At least one thorny problem may occur, however, particularly in the context of a long-term supply contract. Assume, for example, that a buyer has repudiated a contract to purchase natural gas in the second year of a contract that obligated the buyer to purchase natural gas for the productive life of the property. The contract calls for the purchase of 75% of the deliverable capacity of the property at a price of \$5.00 per MMBTU.(16)