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

J. Michael Medina

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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]

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† 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 disputes[5] 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 MTN. MIN. 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. MIN. 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][ii] (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 disputes[8] 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.

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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 minumum 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.

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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 Decontrol, 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

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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 industy 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

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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 contact 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 claims[29] 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

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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]

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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

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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 MTN. MIN. 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]

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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).