Take-or-Pay Conditions in Gas Supply Agreements

Introduction

Take-or-pay provisions are now fairly common in long-term off take and supply agreements in the energy sector, a notable example being gas supply agreements.[1]

In essence, take-or-pay provisions provide that a buyer must pay for specified quantities of energy (gas, for example) from a seller, even if the buyer is unwilling or unable to take such quantities.[2] At the most basic level, take-or-pay clauses require the buyer either to purchase and take delivery of certain quantities of gas, or to pay for the gas regardless of whether it takes delivery.[3]

The aim of these provisions is to ensure that the seller will receive a guaranteed stream of revenue under the agreement, irrespective of the quantities actually taken by the buyer. They often operate where the supplier has had to undertake substantial debt and capital commitments in order for the project to get off the ground in the first place.[4] (At the same time of course, buyers have themselves often had to undertake commitments as well; consider re-gas facilities in an LNG project.)

Although take-or-pay clauses are widely used, the rules applicable to such clauses, under most national laws, are not fully settled. The concern frequently expressed is whether these provisions constitute a form of penalty which a court or arbitral tribunal should not enforce.

One need only take the (rare) situation where a buyer cannot take a quantity of gas but must still pay for it, and couple that with the (rarer) case where the seller is thereby able to sell that gas to someone else.[5] Under a traditional take-or-pay scenario, the buyer will not be able to claim a credit for the other sale, and so the seller is in effect paid twice. The question then arises, is the fact that the buyer is being asked to pay an amount over and beyond the seller's actual loss a matter for concern? And if so, should the provision be held unenforceable as a penalty clause?

One argument against this is that, in the context of gas contracts agreed between large and experienced companies on the basis of legal advice, take-or-pay provisions are not unreasonable and parties should be held to their commercial bargain. This argument is strengthened by the frequent mitigation of the potentially harsh effects of take-or-pay clauses by the use of one or more of the mechanisms described in II.B. A second argument is based on the fact that one of these mechanisms which is often included is "make-up", where the buyer can reclaim the gas for which it paid at a later date. Where the buyer does eventually take the gas, the situation may (depending on the wording of the contract) no longer be

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a breach of contract and could instead be characterised as delayed performance. The initial payment should not therefore be viewed as a penalty for a breach of contract (a point to which I return in Part II.A below). Other technical arguments of a more legal nature seek to characterise the underlying obligation as a simple debt (see III.A below) or an obligation subject to an order for specific performance. These arguments explain why courts and tribunals called upon to review take-or-pay clauses have generally tended to uphold them.

This article is intended to shed light on some of the uncertainties surrounding the legal treatment of take-or-pay clauses, by presenting an overview of the practice of take-or-pay conditions in gas supply contracts (II.) and reviewing how these clauses are interpreted and enforced in common law and civil law systems, as well as under European Union ("**EU**") and certain Arabic laws (III.).

II. Take-or-Pay Conditions in Practice

A. Economic Rationale Behind Take-or-Pay Clauses

1. Take-or-Pay Conditions as a Risk Allocation Mechanism in Long-Term Contracts

A defining characteristic of projects in the energy sector is that they frequently require significant upfront capital investments on the part of producers for the exploration, design and construction of the facilities.

This opens the door to what some economists refer to as the "hold-up problem": certain buyers may have an incentive to take advantage of the investments made by the seller (which strengthen the buyer's bargaining position, since these investments have little value for other uses) to thereby increase their share of the profits generated by the relationship.[6] To help deal with this problem, buyers and sellers enter into long-term contracts, which are intended to guarantee a stream of revenue to the seller on predetermined terms.

In simple terms, the *quid pro quo* involved in these arrangements involves an assumption of different risks. In order to be able to market the gas (in Europe at least) the buyer seeks accommodation and protection through price flexibility, ensuring that the price it pays still allows it to market the gas in its chosen market. This can be provided by price indexation, and—where circumstances warrant—a reopening of the price formula itself. Hence, the seller assumes a degree of price risk over the life of the contract.

Sellers, on the other hand, having committed substantial sums to the project—often backed by banks whose sole recourse is the project itself—require assurances as to ongoing income. Hence, they ask buyers to take supply risk through the imposition of take-or-pay. The aim is thus to ensure that the seller will receive at least a minimum-level revenue stream defined at the outset of the contract.

2. Take-or-Pay as Collateral in Project Financing

As can be readily seen, in addition to being risk allocation mechanisms, take-or-pay conditions may also operate as indirect guarantees in the context of project finance, where the only recourse open to the banks is the project itself. In such cases, a constant revenue stream is generally a condition *sine qua non* of the project's feasibility, and hence financing. This unconditional payment obligation means that take-or-pay contracts may be characterised as a form of guarantee, reportable as such on financial reports.[7] Similarly, buyers may have to seek the approval of their own lenders before entering into agreements subject to a take-or-pay condition.[8]

B. How Take-or-Pay Provisions Operate

There are various types of take-or-pay clauses, although the key mechanism of these provisions is always essentially the same: the buyer is obliged to either take (and pay for) or pay for (even if not taking) a minimum quantity of gas specified in the contract.[9]

Given, however, commercial pressures and the ever-present concern that these provisions may be challenged as (unenforceable) penalties, the industry has usually softened the potentially harsh effects of take-or-pay.

The following elements are examples of the main variables that can alleviate the mechanics of each take-or-pay obligation:[10]

(i) **Take-or-Pay Percentage:** a take-or-pay commitment is generally based on a percentage of the contract quantity, typically expressed as x percent of the deliverable quantity under the contract in the normal course of events.[11] A higher percentage obviously means higher guaranteed cash-flow for the seller. The take-or-pay percentage in gas supply agreements is, in our experience, generally set at between 75 percent and 95 percent of the contract quantity.[12]

(ii) **Periodicity:** the frequency of application defines the periodicity of the imposition of the take-or-pay obligation on the purchaser (monthly, quarterly or yearly). Longer

periods provide additional flexibility to the purchaser, at the expense of reduced protection for the seller.

(iii) **Make-up Quantities:** very often, the buyer has the right to reclaim the gas for which it has paid at a later date, usually subject to a final deadline after which the right is lost (and the right is generally exercisable only once its ongoing obligations have been satisfied in any given year).[13]

(iv) **Adjustments:** adjustments involve circumstances set out in the contract that, if they occur, may result in a reduction of the contract quantity. Such adjustments include, for instance, *force majeure*[14] events, shortfall gas (i.e., quantities that the seller was unable to deliver), or maintenance (i.e., quantities which were not delivered because the facilities were undergoing maintenance).[15]

While beyond the scope of this article, another "softening" mechanism could be where hardship provisions operate, either by way of contract or applicable law, a question which opens up a whole host of other issues.[16]

C. Comparison with 'Take-and-Pay' Provisions

Take-and-pay contracts contain a requirement that the buyer both take delivery of and pay for a set quantity of goods. In contrast to take-or-pay provisions, the buyer does not have the right to refuse to take the minimum contract quantity and instead make a payment to the seller. Nor does the buyer have the right to decide not to take up the goods in a given period and "make-up" the goods in a later period. Evidently, such take-and-pay provisions give little flexibility to the buyer. They are, however, "*appropriate in certain contexts – for example, short- and mid-term LNG sale and purchase agreements.*"[17]

In contrast to take-or-pay provisions, in the event that the buyer fails to take delivery of the agreed minimum contract quantity "*it will be in breach or default of the contract each time such failure occurs, and it will become liable to the seller for damages upon the occurrence of each such breach or default.*"[18]

Moreover, as a seller's potential claim would be a damages claim, the usual rules apply and the seller is obliged to mitigate its loss, which in practice will result in a resale to another buyer. This is in contrast to take-or-pay contracts where "*the seller is under no such mitigation or resale obligation, and if it does manage to resell the quantity not taken by the buyer the seller is entitled to retain the full sales proceeds … and it is not obligated to account to the buyer for such proceeds.*"[19]

III. Validity and Enforcement of Take-or-Pay Provisions

A review of the treatment of take-or-pay conditions in various countries shows certain doubts as to their validity and enforcement; in common law (**A**.) and civil law (**B**.) systems, as well as under EU law (**C**.).

A. Take-or-Pay Conditions in Common Law Systems

Take-or-pay clauses were first included in US gas contracts in the 1960s, playing a key role in the balance of commercial relationships between producers and pipeline companies. Take-or-pay clauses generated significant litigation after the worldwide industrial recession of 1981 – 1982, as buyers were subject to extremely high take-or-pay obligations, for quantities of gas that significantly exceeded market demand and with market prices having dropped well below the contract price.[20]

The validity of take-or-pay conditions is generally not challenged in the US, as courts have frequently upheld this type of provision in principle.[21] This said, the results of the application of these provisions (i.e., the possibility of the seller recovering the full amount under the take-or-pay clause) have in some cases been subject to question.

This uncertainty stems from the application of the Uniform Commercial Code ("**UCC**"), in force in most of the US states, which applies to gas sale contracts. Section 2-708 of the UCC provides that in the event that the buyer refuses to take delivery of the goods, the seller is entitled to "*the difference between the market price at the time and place of tender and the unpaid contract price together with any incidental damages*".[22]

- In certain cases, US courts have held that Section 2-708 applied to the calculation of damages arising out of the breach of a take-or-pay obligation (i.e., where the buyer has not taken or paid for the gas), thus entitling the seller only to the difference between market price and contract price.[23]
- However, other courts have found that take-or-pay clauses are derogations from the general rule of Section 2-708, and the payment obligation is enforceable in full.[24]

Uncertainties used to exist in English law regarding whether take-or-pay obligations are subject to the rule against penalties. The rule provides that English courts will not allow the enforcement of a provision which imposes a penalty on a party which has breached a contract. Penalties, which are unenforceable, must of course be distinguished from liquidated

damages, which are per se enforceable. A provision interpreted as a penalty will be disregarded, and the amount stated therein will not be recoverable as damages.[25] Any loss suffered by the aggrieved party would then be subject to the normal rules governing damages (e.g., proof, mitigation, etc.).

While the English courts have previously recognised, in principle, that take-or-pay clauses fall foul of the rule against penalties,[26] the UK Supreme Court both clarified and significantly reduced the circumstances in which that rule will apply in the recent case *Cavendish Square Holdings BV v. Makdessi and ParkingEye Ltd. v. Beavis* ("**Cavendish Square**").[27] It may now be the case that even if a clause may be seen as providing for a remedy over and beyond a party's true loss (and as such be potentially a 'penalty'), the clause may still survive as a result of its deterrent value.

Lord Neuberger PSC stated in that case that "the true test [of a penalty] *is whether the impugned provision is a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to the legitimate interest of the innocent party in the enforcement of the primary obligation*"[28] [emphasis added]. Lord Neuberger clarified the fact that compensation is not the only legitimate interest a party might have in ensuring the performance of a contract and, indeed, deterring a breach might be a legitimate interest in some circumstances. After *Cavendish Square*, then, it is difficult to imagine the circumstances in which a (still mitigated) take-or-pay clause in a gas supply agreement would be held as 'out of all proportion' to the seller's legitimate interest in steady, ongoing income from the buyer.

Furthermore, Lord Neuberger also set out that "*in a negotiated contract between properly advised parties of comparable bargaining power, the strong initial presumption must be that the parties themselves are the best judges of what is legitimate in a provision dealing with the consequences of a breach*",[29] thereby further limiting the circumstances in which a take-or-pay clause in a gas supply agreement, which almost invariably involves sophisticated parties, will be held as penal under English law.

The rule against penalties was also recently at the center of attention in Australia, in the decision of the Australian High Court in *Andrews v. Australia and New Zealand Banking Group Ltd* ("**Andrews**").[30] This decision concerned a class action brought against a bank, based on a claim that certain clauses included in agreements entered into by the bank (such as clauses imposing late payment fees), were unenforceable, as they constituted penalties.

By way of background, it will be recalled that one rationale for the enforceability of take-or-pay clauses is that there is in fact no breach of contract involved in a failure to take quantities, as the take-or-pay clause provides for payment and/or delayed performance (through make-up gas). In this way, there is no cause for discussing issues relating to damages since there is no breach.

This may not necessarily be the end of the matter, in Australia at least. Under Australian law, the penalties doctrine prevents the enforcement of certain provisions calling for the payment of money, if these provisions are dependent upon a breach of a contract.[31] In this regard, take-or-pay clauses were traditionally not considered as penalties in Australia, since they are not triggered by a breach of contract.[32]

In *Andrews*, the High Court broadened the scope of the penalties doctrine and held that penalties could be found to exist, even if they were not triggered by a contractual breach. The Court noted, in general terms, that a contract provision amounts to a penalty if "*it is collateral (or accessory) to a primary stipulation in favour of a second party and this collateral stipulation, upon the failure of the primary stipulation, imposes upon the first party an additional detriment, the penalty, to the benefit of the second party.*"[33]

This decision suggests that the Australian courts will be prepared to look through the characterisation of take-or-pay clauses by parties relying on them and recognise that such provisions could potentially fall foul of the rule against penalties. Although the legal and commercial justifications for take-or-pay in energy contracts means that this is likely to be the case only in more extreme circumstances, the Andrews decision should prompt caution on the part of drafters of contracts enforceable under Australian law.

There are, of course, a number of other defences raised from time to time, often invoking specific statutory regimes applicable in domestic regimes or more general appeals to public policy (described somewhat uncharitably by some writers as the defence "*never argued at all but when other points fail*"[34]).

B. Take-or-Pay Conditions in Civil Law Systems

In France, although regulations in the energy sector seem to accept the principle of take-or-pay conditions in energy contracts,[35] the French Competition Council ("*Conseil de la concurrence*") indicated that such provisions could raise competitive concerns in the context of the liberalization of the gas market.[36]

In addition, and reminiscent of our discussion above, take-or-pay conditions are exposed to the risk of being construed as contractual penalties ("*clauses pénale*") in the sense of Article 1152 of the French Civil Code.[37] Where a clause is deemed to be penal, a court may review the amount of the penalty and is entitled to reduce or increase it if it is "*excessive or derisory*".[38]

To our knowledge, only one decision, issued by the Court of Appeal ("*Cour d'appel*") of Angers in 2005, has addressed the validity of take-or-pay clauses under French law.[39] In this decision, the Court upheld the annual take-or-pay obligation accepted by one of the parties, and found that this provision was justified in the general context of the agreement. The Court noted, in particular, that the take-or-pay undertaking (i) was made in consideration of the seller's obligation to supply natural gas, and (ii) constituted a "mode of performance of the [buyer's] obligation to take".[40] The Court rejected the argument that this take-or-pay clause could be construed as a penalty under French law. For these reasons, the Court awarded damages to the seller in the amount specified in the take-or-pay clause, as a result of the buyer's failure to take the contract quantity.

Whilst, to our knowledge, the German courts have not yet taken a position on the precise legal rules governing take-or-pay, certain decisions rendered in the context of antitrust cases have touched upon the subject and appear to indicate that take-or-pay clauses are enforceable under German law.[41]

By contrast, take-or-pay clauses raise specific concerns under Russian law:

- Firstly, under Article 16 of the Gas Supply Rules, any provisions calling for liability for failure to take gas for contracts in which the annual volume is less than 10,000 cubic meters, are prohibited.[42]
- Secondly, take-or-pay clauses may be considered unenforceable under Russian law. Gas supply contracts are considered as sale and purchase contracts in the sense of the Russian Civil Code. As such, gas supply contracts are subject to the general rules of the Russian Civil Code regarding sales contracts, such as the rule requiring the quantity of the goods to be clearly specified in the contract. Take-or-pay clauses may well violate certain of these general principles of Russian law.[43]
- Thirdly, take-or-pay clauses are subject to the rule in Article 333 of the Russian Civil Code, which enables courts to reduce the amount of contract penalties in the event that they are deemed to be "unreasonably high".[44] This provision was recently applied in a case decided by the Supreme Commercial Court of the Russian Federation, in which a gas supplier claimed approximately RUB 4 million, as a result of the buyer's failure to take approximately 11 percent of the contract quantity under a take-or-pay obligation.[45] Considering the limited extent of the breach, the court found the penalty to be unreasonably excessive compared to the actual losses incurred by the buyer and reduced the penalty awarded to the supplier to RUB 1 million.[46]

Turning to Switzerland, it was stated in a recent article that: "[t]*he nature of ToP [take-or-pay] clauses under Swiss contract law has not yet been analyzed in Swiss case law or legal literature.*"[47] The author of the article goes on to argue that take-or-pay clauses are nevertheless legitimate and enforceable terms providing for alternative modes of performance within the meaning of the Swiss Civil Code (and, one could posit, the codes of many other countries; see below).

Given that under a take-or-pay clause, the buyer must either (i) take, and pay for, the agreed quantity or (ii) pay the price for this quantity without (yet) taking delivery of it, the buyer is free to choose one of these two options notwithstanding the seller's preference. Upon performing either of these alternatives, the buyer is considered as having fulfilled its obligations under the take-or-pay agreement.

The author thus states that, irrespective of whether gas is later reclaimed, the buyer's payment obligation "*cannot be characterized as a penalty or liquidated damages*" but is neither "*an independent (alternative) obligation*".[48] This can be seen as a feasible basis for the enforcement of this type of obligation (albeit not the only one).

One can see the same type of argument being made under French law as well.[49]

One issue that could arise, even applying this theory, is whether one can establish causa or a "*lawful cause*" underlying the relevant obligation.[50]

Under civil law notions, a buyer's duty to pay should have a cause at the time of the contract in order for that duty to be valid and enforceable. In synallagmatic (commercial) contracts, the "cause" of the debtor's obligation can be found in the

creditor's corresponding undertaking.[51] Where there is no such provision, i.e., when there appears no counterpart granted by the creditor for the performance of the debtor's duty to pay, one could argue that the debtor's duty to pay has no cause and should thus be deemed null and void.

So what is the cause of the debtor's duty to pay without taking? The answer to that question will obviously vary, although if, for instance, the creditor has provided for a "make-up" right, or entered into an exclusivity agreement (meaning it can sell to no one else)[52], or if it has a duty to "*supply or pay*", it seems more likely that courts would consider that the cause requirement is met. The position may be more problematic, however, were there to be no corresponding rights of the nature described.[53]

C. Take-or-Pay Conditions Under EU Law

Take-or-pay conditions fall within the ambit of EU regulation of the gas sector, which currently takes the form of the Third Gas Directive and the application of general EU competition law to the gas industry.

The EU adopted Directive No. 2009/73/EC (the "**Third Gas Directive**") in 2009,[54] as a replacement for Directive No. 2003/55/EC (the "**Second Gas Directive**")[55] in 2003 itself preceded by Directive No. 98/30/EC (the "**First Gas Directive**") in 1998.[56] These three directives are intended to set out the basic rules governing the gas market within the EU, by establishing common rules for the distribution, transmission, supply and storage of natural gas.

One of the key principles of the Third Gas Directive is third-party access to gas transport systems. This principle, set out under Article 32 of the Third Gas Directive, provides, in essence, that the owner of the grid must allow any supplier non-discriminatory access to its gas transmission and distribution system.

The Second Gas Directive does not directly address take-or-pay conditions. However, take-or-pay clauses are listed as one of the possible justifications for derogation from third-party access. In this context, Article 48(1) of the Third Gas Directive provides that a party to a gas undertaking may request a derogation from third-party access under Article 32 of the Third Gas Directive, in case it is subject to serious economic and financial difficulties as a result of its take-or-pay obligations. All of this suggests that take-or-pay obligations are *prima facie* valid, so far as EU legislators are concerned.

Another angle from which take-or-pay conditions may be tackled is EU competition law, notably Articles 81 and 82 of the Treaty Establishing the European Community ("**EC**"). Article 81 EC prohibits agreements or other concerted practices which restrict or distort competition within the Common Market. Article 82 EC prohibits abuse by undertakings of a dominant position within the Common Market. Both Articles 81 and 82 EC are directly effective provisions of EU law: national courts are thus entitled to cancel contracts that breach Article 81 or 82 EC.

Take-or-pay conditions, as part of long-term gas supply contracts, may fall within the ambit of the European Commission policies regarding market foreclosure and/or restriction of competition in the Common Market. The main rule applied by the commission for gas supply contracts was defined in the 2007 *Distrigas* decision:[57] long-term gas supply contracts are not *per se* prohibited, but their impact must be appreciated on an individual basis, in order to determine whether they restrict competition to an unacceptable extent. In assessing the effects of the agreement on competition, the European Commission focuses on various objective criteria (market position of the supplier, availability of the buyer for other suppliers, duration of the long-term supply contract, overall market share and benefits arising from the new contract).

D. Take-or-Pay in Arab-Speaking Countries

States such as Algeria, Egypt, Libya, and Qatar have already entered into take-or-pay agreements. Similarly, Lebanon and Syria have signed a bilateral treaty for the transportation and sale of gas whereby both states are under an obligation to enter into a gas supply contract containing a take-or-pay clause:

- *"Within fifteen days of the date of signature of this treaty, the parties shall sign a treaty for the sale and purchase of gas which shall include the following main provisions: […] the principle of take-or-pay […]."*[58]

In addition, under the Algerian Hydrocarbon Law, it appears that gas supply contracts must contain a take-or-pay provision:

- "*The company or companies in charge of gas supply activity must […] enter into a gas supply contract with each contractor chosen by the national agency for the valorization of hydrocarbon resources (ALNAFT). […] The Contract […] shall contain a "take or pay" clause […].*"[59]

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Despite the common use of take-or-pay clauses in Arab countries, their laws do not generally provide specific rules. There appears to be a general assumption that such clauses are valid. Under Algerian law, for instance, a scholar has recently stated the opinion that take-or-pay conditions are valid and enforceable and that they should not, in principle, be open to challenge under the rules regarding penalties or abuse of rights.[60]

As for their theoretical basis, and given these countries' civil law roots, one possible approach to the issue is again to assimilate these clauses to those providing for an "alternative obligation".

As discussed above in the context of Swiss law, an obligation is alternative if it provides for different types or modes of performance but offers the debtor the possibility to perform only one of them. The Egyptian Civil Code defines alternative obligations as follows:

> "*An obligation is alternative when its object includes numerous [modes of performance] and the debtor is entirely freed by the performance of one of them. The option, in the absence of any special provision in the law or of an agreement by the parties to the contrary, belongs to the debtor.*"[61]

Many other codes contain similar provisions.[62]

IV. Conclusion

Whilst take-or-pay clauses have generally been accepted as enforceable in most jurisdictions, some recent decisions of common law courts do open the way for their validity to be questioned. In particular, Australian courts appear willing to look through the form of contractual obligations and engage in substantive analysis of whether clauses should be unenforceable as penalties.

In practice, this means that the mechanisms which mitigate the effects of take-or-pay clauses may become more important than has previously been assumed. Negotiators and drafters should carefully consider the level of the take-or-pay percentage and the formulation of make-up provisions. Is the seller pressuring the buyer to accept "off-market" terms? Does the buyer have inferior bargaining power? Is the clause as a whole commercially justifiable? Is the provision or any element of it (such as the pricing formula for make-up quantities) punitive?[63]

Sellers under gas supply agreements should not, however, despair. Courts and arbitral tribunals are likely to recognise the strong commercial and legal justifications for take-or-pay clauses in energy contracts. We may still be some time away from seeing take-or-pay clauses held invalid, and this is only likely to happen in the most extreme cases.

Endnotes

1 Take-or-pay provisions may also be found in other types of energy contracts. The writers have seen these in a wide variety of power supply agreements. *See, e.g.*, for an analysis of take-or-pay conditions in wind power purchase agreements, S. Looper, *Take-or-Pay Crisis V2.0: What Wind Power Generators and Providers Failed to Learn from Gas Pipelines' 1980 Dilemma*, 33 Hous. J. Int'l L. 303 (2010-2011).

2 For an illustration of a typical take-or-pay clause, *see* J. M. Medina, *Take-or-Pay Oklahoma Style, 60 Okla. B.J. 705 (1989), p. 705: "Buyer agrees to purchase and receive from Seller or to pay for if available but not taken, a quantity of gas equal to the Sum of the Daily Contract Quantities herein specified…"*

3 In many instances, and as discussed below, the contract grants the buyer a limited right to take delivery of the gas in the future, referred to as "make-up gas".

4 It is often acknowledged that take-or-pay clauses operate as indirect guarantees for the banks financing the seller's project and are a critical condition of the whole operation; *see*, for example, B. Kohl, *Les clauses de take or pay: des clauses originales et méconnues, Journal des tribunaux*, No 6354, p. 349 et s.

5 The reality may well be that the seller has no choice but to evacuate the gas, due to the exclusive nature of the contractual relationship and the difficulty of storing any significant amount of gas.

6 *See A. Creti and B. Villeneuve, Longterm Contracts and Take-or-Pay Clauses in Natural Gas Markets, Energy Studies Review, Vol. 13, No. 1, 200, pp. 75-95, citing O. Williamson, Transaction Costs Economics: The Governance of Contractual Relations,* Journal of Law and Economics, 22, 233-260.

7 *See* S. Hoffman, *The Law and Business of International Project Finance*, 3rd edition, 2008, Cambridge University Press, p. 210.

8 *Id.*

9 In this regard, take-or-pay clauses should not be confused with take-and-pay clauses, which require the purchaser to pay for the minimum quantity of gas and take it. Under a take-and-pay provision, the buyer is in breach of the contract if it pays for the gas but fails to take delivery of it. *See Williams & Meyers, Manual of Oil and Gas Terms, 6th ed., 1984, p. 881.*

10 For a more detailed analysis of the components of take-or-pay conditions, *see* D. O'Neill, *Gas Sale and Purchase Agreements, in Oil and Gas – A Practical Handbook* (G. Picton-Turbervill, ed.), Globe Business Publishing Ltd., 2009, pp. 147-148.

11 *See* J. M. Medina, *The Take-or-Pay Wars: A Cautionary Analysis for the Future*, 27 Tulsa L.J. 283 (1991-1992), p. 288.

12 *See also* D. O'Neill, *supra* note 10, p. 147.

13 The price at which the gas can be reclaimed has been a source of dispute in cases where the contract has been silent. The contract may provide that the price shall be fixed at the time of operation of the take-or-pay obligation (payment), or it may allow for a partial or full adjustment should the prevailing price be different at the time the gas is actually taken. Alternatively, it may provide for a two-stage payment: a certain percentage at the time of payment and the rest at the time of taking.

14 *See* D. R. Rogers and M. White, Key Considerations in *Energy Take-or-Pay* Contracts, King & Spalding Energy Newsletter, April 2013, which discusses the need for force majeure clauses to be carefully structured. Due to the obligations of a take-or-pay clause being worded in the alternative, the seller may argue that a force majeure event will "*excuse the buyer's failure to take up the TOP Quantity [but not] excuse the buyer from paying the seller for such quantity not taken*".

15 *See Ib.*, on how the wording of a take-or-pay clause should "*ensure that the buyer cannot prevent the delivery of the commodity and then claim this would be deduction of the TOP Quantity.*" The clause should "*provide that [the seller's] obligation is satisfied when it tenders, or makes available, the agreed quantity of goods for delivery to the buyer*".

16 See, for example, B. KOHL, R. Salzburger & M. Vanwijck-Alexandre, *Les clauses take or pay: des clauses originales et méconnues*, Journal des tribunaux (No. 6354) 23 May 2009.

17 *See English court revisits "take-or pay" clauses*, Ashurst Energy briefing, November 2012.

18 *See* D. R. Rogers And M. White, supra note 14.

19 *Ib.*

20 *See* J. M. Medina, *supra* note 11, p. 287.

21 *See*, e.g., *Prenalta Corp. v. Colorado Interstate Gas Co., 944 F.2d 677 (10th Cir. 1991); Universal Resources Corp. v. Panhandle E. Pipeline Co.*, 813 F.2d 77 (5th Cir. 1987). As Corbin points out, if this were a penalty, the buyer would have no right to continue to insist on performance: J. PERILLO, *Corbin on Contracts*, Lexis Nexis 2005, Vol. 11, para. 59-10, pp. 592-595. (Interestingly, he goes on to say in the same section, "*Indeed, outside the hydrocarbon world, take-or-pay contracts are generally held to stipulate for an unenforceable penalty.*").

22 *See* UCC, § 2-708 (1997).

23 *See Roye Realty & Dev., Inc. v. Arkla, Inc.*, 863 P.2d 1150 (Okla, 1993).

24 *See Colorado Interstate Gas Co.*, Inc., *v. Chemco, Inc.*, 833 P.2d 786, 788 (Colo. Ct. App. 1992).

25 While not a matter of great practical relevance, some courts have held that the clause can be enforced but only to the extent of the claimant's actual loss. For two cases illustrating the debate, *see Jobson v. Johnson* [1989] 1 W.L.R. 2026 at 1040, and *Scandinavian Trading Tanker Co. AB v. Flota Petrolera Ecuatoriana (The Scaptrade)* [1983] 2 A.C. 694, at 702.

26 *M & J Polymers v. Imerys Minerals Ltd. [2008] EWHC 344 (Comm); E-Nik v. Department for Communities and Local Government [2012] EWHC 3027 (Comm).*

27 *[2015] 3 WLR 1373*

28 *Ibid [32]*

29 *Ibid [35]*

30 *See Andrews v. Australia and New Zealand Banking Group Ltd* [2012] HCA 30.

31 *See Interstar Wholesale Finance Pty Ltd v. Integral Home Loans Pty Ltd* [2008] NSWCA 310.

32 *See* K. Cahill and M. Cooke, *High Court Ruling Impacts Take-or-pay Clauses*, 7 December 2012, available online at http://www.lexology.com.

33 *See* Australian High Court, *supra* note 29, para. 10.

34 *Richardson v. Melish*, 2 Bing. 229, 252: cited by J.M. Medina, G.A. McKenzie and B.M. Daniel, *Take or Litigate: Enforcing the Plain Meaning of the Take or Pay Clause in Natural Gas Contracts*, Arkansas Law Revue [vol. 45] 185, p. 218.

35 *See* Law No. 2003-8 dated 3 January 2003, concerning the gas and electricity markets and the public energy service, implementing the First Gas Directive. French law has remained unchanged after the entry into force of the Second and Third Gas Directives, which are similar to the First Gas Directive on these issues.

36 French Competition Council, Opinion No. 99-A-15, dated 5 October 1999, available in French at www.autoritedelaconcurrence.fr/pdf/avis/99a15.pdf.
37 *See* Article 1152 of the French Civil Code: "*Where an agreement provides that he who fails to perform it will pay a certain sum as damages, the other party may not be awarded a greater or lesser sum. Nevertheless, the judge may even of his own motion moderate or increase the agreed penalty, where it is obviously excessive or ridiculously low. Any stipulation to the contrary shall be deemed unwritten.*"
38 *See* Article 1152, sub-paragraph 2, of the French Civil Code.
39 *See* Court of Appeals of Angers, 15 June 2005, *SA Styrpac c/ Gaz de France*, No. 04/01783.
40 *See Ib.*, p. 4: "*Styrpac's obligation to take, as described above, is reciprocal to GDF's supply obligation. The payment of the remainder of gas not taken during the annual period constitutes a mode of performance of the obligation to take.*" [Free translation]. The French original reads: "*L'obligation d'enlèvement à la charge de Styrpac, libellée comme rappelé ci-dessus, est réciproque à l'obligation de fourniture contracté par GDF. Le paiement du reliquat de gaz non enlevé au cours de la période annuelle constitue un mode d'exécution de l'obligation d'enlèvement.*"
41 Take-or-pay clauses were taken into consideration by the German competition authorities (*see*, e.g., Court of Appeals of Düsseldorf, 20 June 2006, 2 Kart 1/06) in the context of certain gas import agreements considered under EU law. However, the German courts have not taken a position on the take-or-pay conditions themselves.
42 *See* Russian Gas Supply Rules, Article 16: "*Failure to accept the gas should not give the buyer the right to subsequently claim an increase in gas supply in excess of the daily rate. In case of failure to accept the gas by the buyers who consume up to 10000 thousand cubic meters of gas per annum in accordance with the concluded gas supply agreements the unaccepted volumes of gas should not be paid for and the sanctions for lack of acceptance are not provided*" [free translation].
43 *See, inter alia*, Articles 455, 457(2), 466, 475, 480, 484(3) and 393(1) of the Russian Civil Code.
44 *See* Article 333 of the Russian Civil Code.
45 *See* Order of the Supreme Commercial Court of the Russian Federation dated 28 May 2009 No. VAS-6632/09.
46 *Id.*
47 *See* M. Iynedjian, Gas Sale and Purchase Agreements under Swiss Law, ASA Bulletin, (Kluwer Law International 2012 Volume 30 Issue 4), pp. 746-757, p. 748.
48 *Id.*
49 *See* Article 1189 of the French Civil Code.
50 Under French law, for instance, Article 1108 of the French Civil Code provides that "*Four requisites are essential for the validity of an agreement: The consent of the party who binds himself; his capacity to contract; a definite object which forms the* ***subject-matter*** *of the undertaking;* ***a lawful cause in the obligation***" [emphasis added; free translation], and Article 1131 provides: "*An obligation* ***without cause*** *or with a false cause, or with an unlawful cause, may not have any effect*" [free translation].
51 This is described as the immediate reason why the debtor agreed to be bound by contract, or *causa proxima*.
52 Often the case in the early days of the US gas industry, *see* J.M. Medina, G.A. McKenzie and B.M. Daniel *supra* note 33, p. 190.
53 Even here, however, there is an argument that a court should uphold the debtor's duty to pay on the same basis as courts apply to upholding autonomous guarantees (*viz* that under business principles, such a corresponding obligation necessarily exists and one need not identify it in precise fashion); like autonomous guarantees, take-or-pay obligations stem from international business practices and operate as (indirect) guarantees in the context of project finance (*see* above).
54 *See* Directive 2009/73/EC of the European Parliament and the Council of 13 July 2009 concerning common rules for the internal market in natural gas.
55 *See* Directive 2003/55/EC of the European Parliament and the Council of 26 June 2003 concerning common rules for the internal market in natural gas.
56 *See* Directive 98/30/EC of the European Parliament and of the Council of 22 June 1998 concerning common rules for the internal market in natural gas.
57 *See Distrigas*, MEMO/07/407, dated 11 October 2007.
58 [Free translation], Article 5, "*Agreement Concerning the Principles of Delivery and Sales of Crude Gas Between Syria and Lebanon*", available in Arabic at www.syrleb.org/conference.asp?conftype=1.
59 [Free translation; emphasis added], Article 64(4), Algerian Hydrocarbon Law, available in French at www.droit-afrique.com/images/textes/Algerie/Algerie_Loi_hydrocarbures_2005.pdf.
60 See N.-E. Terki, *Penalty clauses and "take or pay" clauses in international long term contracts*, IBLJ No. 2, 2014, p. 109, pp. 119-121.
61 [Free translation].
62 One point to keep in mind regarding nomenclature in Arab-speaking countries; whereas one refers in these jurisdictions to "penalty clauses", in reality the discussion in those countries frequently involves liquidated damages clauses. Under the Egyptian Civil Code, for example, a penalty clause is a provision whereby "*[t]he parties […] fix, in advance, the amount of damages*" due in the event of non-performance of an obligation (Article 223 Egyptian Civil Code: "*The parties may fix in advance the amount of damages either in the contract or in a subsequent agreement […].*" [Translated from original in Arabic by Perott, Fanner & Sims Marshall]). The civil codes of Algeria (Article 183 Algerian Civil Code: "*The parties may fix in advance the amount of damages either in the contract or in a subsequent agreement […].*" [Free translation]), Bahrain (Article 225 Bahraini Civil Code: "*Unless the object of the obligation is a sum of money, the parties may fix in advance the amount of damages either in the contract or in a subsequent agreement.*" [Translated from original in Arabic by Gulf Translations WLL]), Iraq (Article 170(1) Iraqi Civil Code: "*The parties may fix in advance the amount of damages either in the contract or in a subsequent agreement […].*" [Free translation]), Jordan (Article 364(1) Jordanian Civil Code: "*The parties may fix in advance the amount of damages either in the contract or in a subsequent agreement subject to the provisions of the law.*" [Free translation]), Kuwait (Article 302 Kuwaiti Civil Code: "*Unless the object of the obligation is a sum of money, the parties may fix in advance the amount of damages either in the contract or in a subsequent agreement.*" [Free translation]), Libya (Article 226 Libyan Civil Code: "*The parties may fix in advance the amount of damages either in the contract or in a subsequent*

agreement […]." [Free translation]), Qatar (Article 265 Qatari Civil Code: "*Unless the object of the obligation is a sum of money, the parties may fix in advance the amount of damages either in the contract or in a subsequent agreement.*" [Free translation]), Syria (Article 224 Syrian Civil Code: "*The parties may fix in advance the amount of damages either in the contract or in a subsequent agreement […].*" [Free translation]), and the United Arab Emirates ("**UAE**") (Article 390 UAE Civil Code: "*The contracting parties may fix the amount of compensation in advance by making a provision therefor in the contract or in a subsequent agreement, subject to the provisions of the law.*" (J. Whelan, UAE Civil Code and Ministry of Justice Commentary – 2010, Thomson Reuters 2011, p. 268) contain similar provisions. Likewise, the International Islamic Fiqh Academy ("**IIFA**") defines a penalty clause as a contractual determination of the damages due to the creditor in the event that the debtor does not perform its obligations under the contract (Article 4 of Decision No. 109 dated 28 September 2000 of the International Islamic Fiqh Academy, available in Arabic at www.fiqhacademy.org.sa.).

63 Of course, some of the "heat" has been taken out of the argument by the absence of destination clauses in a number of jurisdictions, which have been seen as an important factor in the antipathy of competition authorities to these clauses (*see*, for example, the German downstream decisions over the last few years, admirably described by Kim Talus in his recent article, *Long-term Natural Gas Contracts and Antitrust Law in the European Union and the United States*, 4 (2011) 3 J World Energy Law Bus. doi:10.1093/jwelb/jwr015).