 Continued from page 7

cific limitations, it should be remembered that the lessee has the right to locate wells and equipment as he may reasonably determine necessary.

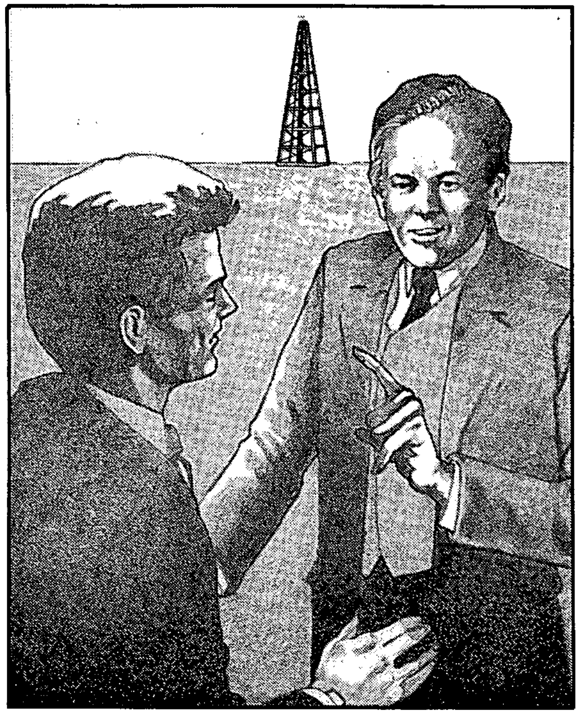
Lessors who own property subject to an agricultural lease or which holds the promise of lignite mining should also be concerned about the possible conflict between the rights granted under an oil and gas lease and rights previously granted or that may be granted under other leases. A broadly worded warranty clause in any of the leases might cause the lessor to be dragged into a fight between the various lease holders. One way of circumventing such potential problems is to provide that any right granted to the oil and gas lessee are to be exercised in a manner which will not unnecessarily interfere with other operations "which may then or in the future be conducted on the premises."

A Mother Hubbard clause, sometimes called a cover-all clause, is a phrase at the end of the granting clause that typically provides that "this lease also covers and includes any and all land owned or claimed by the lessor adjacent or contiguous to the land described hereinabove . . ." The Mother Hubbard clause is designed to protect the lessee against the inadequate legal description. However, the typical formulation of the Mother Hubbard clause is so broadly drafted that it could include lands of the lessor that the lessor had no intention of leasing. Therefore, the Mother Hubbard clause should be deleted by the landowner's attorney.

It is preferable to use a full legal description in the lease granting clause, though "bounded by" descriptions identifying the land by reference to the ownership of surrounding tracts are sometimes seen. The lessor's attorney may want to limit the granting with a depth limitation, effectively reserving to the lessor the rights to depths deeper than those tested by wells drilled on the premises. With luck, the unleased depths can be the subject of further negotiations at a later date.

The Habendum Clause

The habendum clause states the period of time for which the lease will extend. Typically, it provides for a stated number of years of a *primary term*—during which the lessee need do nothing so long as delay rentals are paid—and a *secondary term* which will last as long as oil and gas are being produced or operations are conducted on the lease.



The length of the primary term is negotiable. In general, a short primary term is better for the lessor than a long primary term, however.

There is virtual unanimity from the courts that the term "production" as used in the secondary term provisions requires production "in paying quantities." Furthermore, most states require that there be actual production which is marketed in order to extend the lease. These interpretations are generally an adequate protection for the lessor's interest.

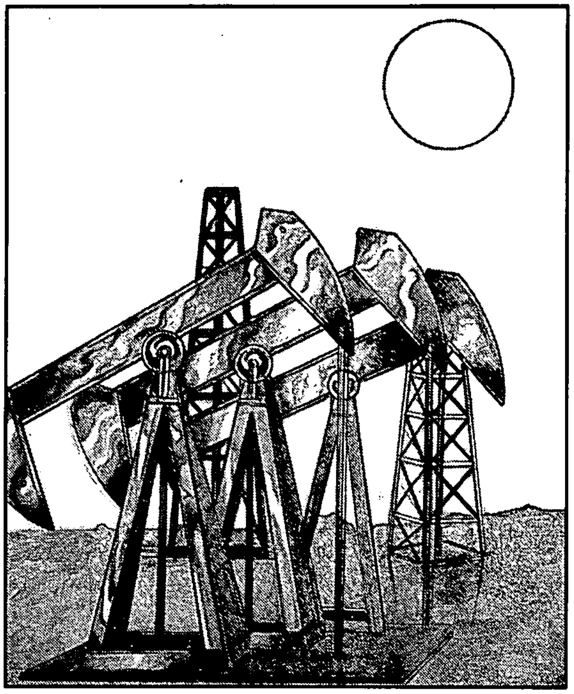
The Royalty Clause

The lessor's royalty is a percentage share of production, free of the expenses of production. Typically, royalty clauses provide for a "standard" one-eighth as the landowner's share. In fact, you can often do better for your clients.

In addition to the percentage of royalty, there are other important considerations to the landowner's bottom line that should be considered by his attorney.

Courts in many states have held that the lessor must bear his proportionate share of costs subsequent to production, such as costs of compressing, transporting, and dehydrating the natural gas. Those decisions often lead to dispute between the landowners and oil com-

Continued on page 58



MCI Communications Corp. v. American Telephone & Telegraph Co., 708 F.2d 1081 (7th Cir. 1983). The key issues in establishing an essential facilities claim are (i) whether the facility is so essential in conducting a particular business that a party deprived access would be placed at a severe competitive disadvantage, and (ii) whether it would be economically impractical for the person seeking access to duplicate the facility. It is expected that this area of the law, insofar as it applies to the natural gas industry, will develop rapidly as direct federal regulation is phased out of various areas of the industry.

The current gas bubble has presented new challenges to producers seeking a market for their natural gas. The existing regulatory framework provides several means by which producers can market their natural gas production directly to the end users. Nevertheless, this framework remains complex and many potential direct sale transactions may not be economically feasible unless the sale and transportation arrangements can be structured to avoid the major administrative hurdles. However, given the proper structuring of such transactions, the direct producer sale can be a very attractive arrangement for both producer and end user.

for the Lessee *Continued from page 8*

The secondary term of the lease gives the oil company the right to the property as long as it is profitable to produce. Under no circumstances should an oil company accept a fixed-term lease. It is clear that a lease will terminate at the end of a fixed term, even though it is still producing prolifically.

The term *production*, as it is used in the term clause, generally is interpreted to require merely that operating revenues exceed operating costs over an economically significant time period. Occasionally, however, the lessor will propose to modify a term clause to define production in terms of an average daily, monthly, or annual production, e.g., "production shall be considered to be in paying quantities so long as the proceeds of oil and gas production shall total at least $25,000 each calendar year." Whether that is acceptable will depend upon (a) the amount of production required, (b) the expected production decline curve, (c) the susceptibility of production to interruption, and (d) how badly your client wants the lease.

Around the turn of the century the courts held that, because the primary consideration for the grant of an oil and gas lease was the expectation of the parties that production would be obtained on the lease, there was a promise implied when the lessee accepted the lease that it would develop the premises within a reasonable period of time. Recognition of the implied covenant to test undercut the first important goal of the lessee in the lease; it imposed an obligation to drill.

The Delay Rental Clause

The implied covenant to test was countered by the oil industry by inserting a delay rental clause in the lease. The clause specifically disclaims any obligation to test the premises during the primary term. Because of this specific provision, there can be no implied covenant to test.

Typically, leases are drafted so that failure to pay rentals properly is a special limitation to the lease primary term and the lease terminates "unless" delay rentals are paid. In order to be properly paid, delay rentals must be paid (a) to the proper persons, (b) on or before the due date, (c) in at least the amount provided for, and (d) in the manner provided for. Under "unless" lease forms, failure to comply with all of these tests will cause automatic lease termination.

Lease prices have increased so dramatically over the last ten years that some lease draftsmen have altered the delay rental provisions to try to avoid automatic termination in the event of improper payment. One way is to convert the payment of rentals from a special limitation to a promise; the lessee promises to pay rentals *or* commence drilling operations. Under the "or" form of delay rental clause, often seen in California and Appalachia, the result of improper payment is liability for the rental promised rather than automatic termination. Another approach is to retain the usual "unless" language but modify it with savings language providing that termination will not take place if an attempt is made to make proper payment. Such language was recently held effective in *Kincaid v. Gulf Oil Corp.*, 675 S.W.2d 250 (Tex. App. 1984).

Some mineral owners object to "or" leases or rental savings clauses. They are unrealistic. Quite simply, it makes no business sense for an oil company to pay hundreds of thousands or even millions of dollars to acquire a lease that will automatically terminate if a mistake is made in payment of a few hundreds of dollars in delay rentals. The attorney representing an oil company in negotiating leases should insist that his client be protected.

Another alternative to the traditional "unless" lease is the paid-up lease. A paid-up lease does not provide for payment of delay rentals; they are "paid up" in advance. Negotiation of paid-up leases is growing in favor among oil companies, because they avoid the risk of inadvertent loss inherent in "unless" leases. However, creating a paid-up lease can be difficult.

It is preferable to use a form drafted specifically as a paid-up lease. However, if it is necessary to modify an "unless" form, do *not* just cross out the drilling-delay rental clause. That may cause ambiguity as to your client's right to hold the lease by payment of shut-in royalties, if the shut-in payment is related to the delay rental amount. Better practice is to complete the delay rental clause, and then note elsewhere in the lease that it is paid up, and that there is no obligation to pay rentals or drill during the primary term.

Defensive Clauses

As I have noted, all modern-day oil and gas leases include defensive clauses to protect the lessee against premature termination for failure to obtain actual production by the end of the primary term. Defensive clauses include (1) the operations clause, (2) the *force majeure* clause, (3) the shut-in royalty clause, and (4) pooling and unitization clauses. Negotiation of alterations to these clauses can be disastrous.

Because most major oil-producing states require actual production and marketing to extend the lease into the secondary term, almost all modern-day oil and gas leases include an operations clause, which specifically provides that commencement of operations on the premises will extend the lease so long as they continue, even without production.

One alteration occasionally negotiated by mineral owners is a provision that the lease will terminate unless a well is "completed" by the end of the term. That should be unacceptable to the oil company, because there are myriad reasons that it may not be possible to complete a well before the end of the term. There is some confusion as to what "completion" means, but it probably requires only that a well be ready to produce. In contrast, the term "commencement," requires only that there be some activity on the land directly related or preparatory to drilling, done in good faith and diligently pursued.

Less troublesome, at least if your oil company client understands its requirements, is a provision that permits the lease to be held by operations, but defines operations in a restrictive way, e.g., "actual drilling operations" requires that a drilling bit actually bite into the earth by the end of the primary term.

The purpose of the *force majeure* clause in the modern-day oil and gas lease is to protect the lessee against loss of the lease in a situation in which a "superior force" beyond his control prevents actual production.

Force majeure is a term that does not have a clearly defined meaning. Therefore, the courts look to the language of the *force majeure* clause to determine what kinds of events will permit extension of the lease. Recent events have shown the importance of *force majeure* language that specifically refers to market conditions or regulatory action as *force majeure* occurrences that will excuse actual production. However, many forms omit one or the other. In addition, some have argued that lessors ought not to agree to regulation as a soure of *force majeure*. *See* Houston and Merrill, *A Suggested Oil and Gas Lease Form*, 43 NEB. L. REV. 471 (1964).

Lessors do not often attempt to negotiate modifications of *force majeure* clauses. Perhaps the greatest damage to the industry is self-inflicted, through the selection of lease forms with narrow *force majeure* provisions. For example, it is important that the *force majeure* clause interrelate with the operations clause to excuse a failure to conduct drilling operations as well as a failure to produce in the event of *force majeure*. If that is not done, the lease will terminate if unusual weather conditions or other *force majeure* events prevent the conduct of drilling operations.

The shut-in royalty clause is included in the oil and gas lease to provide for constructive production in the event that wells on the lease are shut in. It is not an essential defensive clause in those few states, like Oklahoma, where a mere capability of production is sufficient to extend the lease into the secondary term. However, in most states, where the lease will terminate at the end of the primary term unless there is actual production, the shut-in royalty clause is an absolute *must*, for without it the lessee may lose a proven lease and a well capable of producing profitably. Yet, there are forms currently available that do not contain a shut-in royalty clause.

In recent years, negotiators for lessors have frequently sought to modify shut-in royalty clauses. Their attempts have taken at least three different directions.

Typically, printed form leases provide for shut-in royalties to be paid in an amount equal to the delay rentals agreed upon, which is usually a nominal one dollar per acre. Lessors' negotiators sometimes insist upon divorcing the amount of shut-in royalties from the amount of delay rentals to impose an economic penalty upon the lessee when wells are shut in, e.g., shut-in royalties of $20 per acre covered by the lease. If the price is not too high, this modification is acceptable, though it complicates lease adminstration.

Lessors have also negotiated to limit the circumstances under which the shut-in clause can be invoked. For example, the shut-in clause may be modified so that the only circumstances in which the well may be shut in and the lease preserved under the shut-in clause is where there is a lack of market for the gas. That is too restrictive, for there may be many legitimate reasons for shutting in a well.

The most dangerous of common alterations to the shut-in royalty clause is a time limitation, e.g., "Notwithstanding anything to the contrary herein contained this lease may not be maintained by the payment of shut-in royalties and without actual production for more than two years after the end of the primary term." Many lessees agreed to such time limits in leases negotiated in the 1970s. They could not conceive of a time when gas wells would be shut in for more than two years. They were wrong, and some will lose their leases in the 1980s as a result.

Pooling and Unitization Clauses

Pooling and unitization clauses in the modern-day oil and gas lease serve two functions, both of which are related to the fundamental purpose of the lease. First, they give the lessee the flexibility to extend several leases into the secondary term by the drilling of a single well. Such clauses typically provide that:

> Operations for drilling on or production of oil and gas from any part of the pooled unit composed in whole or in part of the land covered by this lease . . . shall be treated for all purposes except the payment of royalties on production from the pooled unit as if the same were included in this lease.

Second, pooling and unitization clauses may be used by the lessee to expedite secondary recovery operations, which will increase the profitability of the leases as well as extend them.

Many lessors take a jaundiced view of pooling clauses, and there is some basis for their concern. The courts have consistently held that the burden is upon the lessor to show a breach of good faith for the lessee's use of a pooling or unitization clause.

In recent years, some lessors have sought to delete the pooling clause. In a state like Oklahoma, where compulsory pooling or unitization by conservation agency decree is readily available, this may be tolerable. However, it is not desirable because it limits the lessee's flexibility. In a state like Texas, it is simply unworkable, because it is difficult to qualify for forced pooling under Texas statutes, and that a friendly lessor may not be so friendly when asked to sign a voluntary pooling agreement.

One alteration to the pooling clause of an oil and gas lease that may be acceptable to your oil company client is a Pugh clause, sometimes called a Freestone rider. These clauses modify the usual form of a pooling clause by severing producing and nonproducing portions of the lease:

> Notwithstanding anything to the contrary

> herein contained, drilling operations on or production from a pooled unit or units established under the provisions of [the pooling clause] hereof or otherwise embracing land covered hereby and other land shall maintain this lease in force only as to the land included in such unit or units.

The effect of the Pugh clause or Freestone rider is to limit the lessee's ability to hold the lease premises without actually drilling every part of it.

A variation of the Pugh clause goes further. This is the "vertical" Pugh clause:

> Notwithstanding any other provisions herein contained, after the expiration of the primary term hereof production from the leased premises shall maintain this lease in force only above a depth of 100 feet below the deepest well then producing in paying quantities on the leased premises . . . .

An even more extreme formulation will limit the lease to the wells or formations actually producing. While a lessee can probably live with some form of a vertical Pugh clause, they should be avoided.

Royalty Clause Alterations

The royalty clause is the main lease provision for compensation of the lessor. Therefore, oil companies should be particularly sensitive to its terms.

Until the mid-1970s, the oil and gas lease royalty was more or less fixed by custom at one-eighth, except in California, where it was generally one-sixth. That custom is a victim of rising oil prices. Today, lease royalty is whatever is negotiated by the parties. Royalty fractions range from one-eighth to one-third.

Royalty provisions may be modified in more subtle ways, however. These modifications may be of greater importance to ultimate profitability than the percentage royalty provided for.

In cases in Texas, Kansas, Montana, and Mississippi, courts have held that a gas royalty clause calling for royalties to be calculated on the "market value at the well," refers to market value when the gas is delivered, rather than to the contract price for which it is sold, less costs subsequent to production. Accordingly, some lessors have begun negotiating for market value gas royalty clauses in their leases. These are to be avoided, if at all possible, because they may subject the oil company to royalty liability far in excess of that anticipated when the lease is taken. Ironically, many printed form leases inadvertently give the lessor a market value royalty clause.

Delays in the payment of royalties have become an increasing concern to lessors. Therefore, some lessors have negotiated for clauses that will permit them to declare the lease forfeit if royalties are not paid on a timely basis. Though forfeiture clauses will be strictly construed by the courts, they should not be agreed to by lessees. The risk of inadvertent loss of the lease is too great.

A more reasonable negotiated provision, now imposed by statute in several states (including Texas and Oklahoma), is payment of interest on royalties not paid on a timely basis. I think that such provisions are hard to argue against; if you hold another's money, you ought to pay interest on it unless you place it in escrow or trust.

It is easy for even experienced oilmen to miss the forest because of all the trees that get in the way in lease negotiations. The business decisions are for your oil company client, of course. However, the natural resources lawyer can help his or her clients taking leases by counseling them upon the purpose and structure of the basic clauses so that negotiated changes in a printed form do not interfere with the basic purposes of the lease.

for the Lessor *Continued from page 9*

panies over what costs are properly deductible and how they should be calculated. Such disputes can be avoided by the landowner's attorney by providing in an addendum to the lease that the lessor's royalty is not to be charged either directly or indirectly with such expenses. I use the following formulation: "expenses of production, gathering, dehydration, compression, transportation, manufacturing, processing, treating, or marketing of gas, oil, or any liquefiable hydrocarbon extracted therefrom."

Typically, royalty provisions for gas require the lessee to pay the lessor the royalty percentage calculated on the amount realized by the lessee, computed at the mouth of the well. Such language does not protect the lessor's interest adequately if the market price for gas in the area increases faster than the price set under the contract negotiated by the lessee. When I can, I delete the references in the royalty clause to the "amount realized," substitute a reference to "market value," and add a clause similar to the following:

> For the purpose of computing royalty under the terms of this lease due and payable on the production of gas or casinghead gas which may be produced from or attributable to this lease, the market value of the gas or casinghead gas, if applicable, produced from or attributable to the lease premises shall be the contract price received by lessee. If lessee shall by contract sell or otherwise dispose of gas or casinghead gas which may be produced from or may be attributable to this lease to any parent, subsidiary, or affiliate or lessee, through stock ownership, joint operation or otherwise, for the purpose of computing royalty during the period of such contract, the market value of the gas or casinghead gas, as applicable, produced from or attributable to the lease premises shall be the higher of the contract price received by lessee or the average of the three highest prices paid for gas or casinghead gas of like quality, quantity, vintage, and federal classification produced from any field located in Texas within a 50-mile radius of the leased premises and sold under a sales contract having a term of not less than three (3) years.

Royalty on oil is usually payable in kind. This gives the landowner the right to make his own arrangements for sale. Often, leases permit the lessee an option to purchase oil at the market price prevailing in the field where produced. It is a good idea to strike such language to preserve the lessor's flexibility to bargain.

It may also be desirable for the lessor to retain the right to take his royalty share of gas in kind. It may be easier for the lessor to make his own arrangements for sale than to argue with the lessee about what is a "fair" price and what costs, if any, are properly deductible from the royalty share. This can be accomplished by an addendum to the lease that the lessor has the right at any time and from time to time to take in kind his royalty share of gas produced, upon ninety-days' notice to the lessee. The language should specifically state that lessee does not have the right to sell or commit the royalty share of gas without prior written consent of the lessor.

A frequent source of concern and aggravation for the lessor is the lessee's failure to pay royalty promptly. One way to minimize such a problem is for the landowner's attorney to negotiate a forfeiture provision. I suggest the following:

> If lessee shall fail or refuse to make the payment of any sum due by the provisions of the lease as royalty on the production within three (3) months after same shall become due, this lease may be subject to forfeiture by lessor by notice given in writing to lessee at the address provided by the lessee. Such notice shall recite the fact constituting the default and the forfeiture.

Recently, the Texas legislature enacted Title 3, Chapter 91, Subchapter K, Payment for Proceeds of Sale, which provides that the proceeds from the sale of oil or gas production from an oil or gas well must be paid within 120 days after the end of the month of the first purchase. Thereafter, payments must be made according to the frequency of payments specified in the lease or division order between the payor and the payee. The law requires that if a payment is not made as required, the payor must pay interest to a payee at the rate charged on loans to depository institutions by the New York Federal Reserve Bank, unless the parties have agreed otherwise. Such statutes, which have now been enacted in several states, should minimize the instances of slow pay.

Shut-In Well Clause

The shut-in well clause typically appears as a part of the royalty clause. Generally, it is applicable to gas only and it provides that a lessee may hold a lease even though there is no production from it, when there is a gas well on the premises that is ***shut in*** and a shut-in royalty is paid. The purpose of the shut-in clause originally was to allow a lessee a chance to obtain a reasonable market for the gas. However, as typically drafted, the language is vague to allow the lessee the sole discretion whether to shut in a well and to permit the lessee to hold the lease for years simply by paying a nominal shut-in royalty. I like to limit the shut-in clause to a reasonable period of time, for example, two years.

Pooling and Unitization Clause

The pooling and unitization clause is included in the oil and gas lease to give the lessee the possibility to conform its operations on the surface to the geological facts of the underground formations. However, the language of the clause is too broad from the viewpoint of the lessor.

Pooling and unitization clauses typically give the lessee the right to pool and unitize a tract of land without any consultation with the lessor. A lessee might extend a lease without drilling on the leased land merely by including small portions of the leased premises in a unit where drilling or production is occurring. Because of the potential abuse of the powers of the clause, it is preferable from the landowner's point of view that his consent be required for the establishment of units on a case-by-case basis.

Most pooling and unitization clauses also provide that drilling operations on or production from a pooled unit will maintain the lease as to those portions of the leasehold tract located outside the unit. Under such a formulation, it is theoretically possible for a lease covering 100 acres to be maintained as to all 100 acres, from the surface to the center of the earth, by the inclusion of only one acre from the tract in a shallow drilling unit. A *Pugh clause* or, it is called in Texas, a *Freestone rider,* may be added as a rider to the lease to preclude this possibility. Such clauses modify the pooling clause to provide that only the portion of the lease included in the unit will be maintained by unit operation.

Delay Rental and Partial Release Clause

The delay rental clause allows the lessee to defer commencement of drilling operations during the primary term by paying delay rentals to the lessor. Typically, delay rental clauses are of the *unless* type, and failure to pay or tender rentals on a timely basis will terminate the lease in its entirety. However, in recent years, many oil companies have started using lease forms that contain savings clauses that provide that the lease will not automatically terminate for failure to pay delay rentals. Obviously, such clauses are contrary to the lessor's interests and expectations, and they should be struck when encountered.

In addition, the delay rental clause often gives the lessee the right to release all or any portion of the leased premises, while maintaining the lease upon the balance. Since the release of portions of the leased premises may reduce your client's expected income, you may decide that it is in his best interest to attempt to prohibit partial surrender.

Operations and Offsetting Production Clause

Though the courts in most states have interpreted the term *production* that is used in the habendum clause as requiring actual production in marketing and paying quantities, most oil and gas leases change this rule so that operations anywhere on the land begun within the primary term will maintain the lease so long as they are continued. I do not object to such a provision, for my client's interest lies in production being obtained. However, printed form Producers 88 leases often contain language that attempts to limit what would otherwise be the lessee's obligation to protect the premises by operations, which should always be unacceptable to the landowner's attorney. For example, leases in Texas frequently contain the following language:

> In the event of a well or wells producing oil and gas in paying quantities should be brought in on adjacent land and within three hundred thirty (330) feet of and draining the lease, or acreage pooled therewith lessee agrees to drill such offset wells as a reasonably prudent operator would drill under the same or similar circumstances.

Though that language may appear to your lessor client to be giving him something, its effect is to exclude any obligation to protect the premises from drainage by operations more than 330 feet away.

The Assignment Clause

Oil and gas lease printed forms generally give the lessee the specific right to assign his leasehold interest. Your lessor client may want to protect himself from having to accept a debtor whose solvency and reputation are questionable. Frequently, lessors would not grant a lease were they not under the impression that a particular company would develop the property.

It is simple to modify the lease to provide that the lessee may not assign its interest without the lessor's approval. On the other hand, a lessor should also realize that certain types of assignments are necessary to finance oil and gas exploration. It may be that it would be sufficient for the lessor's interest to modify the lease to require that the lessee furnish notice that the lease is being assigned to a third party. Notice keeps the lessor informed of the current lessee with whom he must deal.

Warranty Clause

I automatically strike the warranty of title from every printed form lease presented to my clients. The warranty clause of the oil and gas lease obligates the lessor to defend title to the property lease if it is questioned. The lessor could incur substantial legal expenses in the event of such title disputes. Unless the lessor has a recent and extensive title examination showing good titles, he is ill advised to give a warranty.

Deletion of the warranty clause may not fully protect a lessor from liability associated with failure of title. That is because several states have found that an implied warranty is created by the use of "grant, lease, and let" in the granting clause. Therefore, I prefer a rider paragraph expressly disclaiming any warranty of title.

Force Majeure

The *force majeure* clause is included in an oil and gas lease to preserve the lease when the lessee, because of *superior force* beyond its control, is unable to produce or operate. However, frequently *force majeure* clauses seek to excuse the lessee when there is a scarcity of equipment or failure of carriers to transport or furnish facilities for transportation. This sort of formulation goes far beyond the legal theory of *force majeure* and should be struck. *Force majeure* should exclude that which human prudence could either foresee or prevent.

If a lessor's bargaining leverage allows more demanding concessions to be rung out of a lessee, then I suggest a modified *force majeure* provision. I sometimes insert a paragraph that limits the duration of any excused delay in performance to two years, limits the effect of the delay to the leased acreage specifically affected by *force majeure,* and provides for rental payments during the excused period.

A judicial tendency toward strict interpretation of lease provisions against the lessee has resulted in the evolution of printed forms that tend to favor the lessee. Since most printed forms are lessee's forms, such forms must be closely examined by a lessor prior to execution. As a practical matter, there is little possibility that any lessee will acquiesce to all of the recommendations suggested herein. Accordingly, a lessor will need to inventory and identify his primary interests, concerns and needs; furthermore, a lessor will then need to assign priorities to his concerns so as to further identify his hard bargaining issues and his concessionary issues.

Should negotiations on several of the suggested recommendations fail, the debate concerning such issues may, nevertheless, disclose to the lessor the true intent and character of the potential lessee, revealing potential problem areas before the ink of a lessor's signature has dried on the dotted line.

The oil and gas lease is a complex document but flexible enough to be tailored for particular needs. Be careful, concise, and to the point when changing or adding language, otherwise the ambiguity may be self-defeating should a court of law be unable to decide its meaning.

New Federal Regulation *Continued from page 31*

off-system customers, on a non-arbitrary basis. The term *non-arbitrary* is chosen advisedly, because the Commission probably cannot mandate that pipelines render open, nondiscriminatory transportation services to all who request them, as end users and others have urged. There may occasionally be legitimate reasons for limiting access to transportation services. In recognition of the more compelling of these, the Commission might permit pipelines to make the availability of transportation dependent upon other factors, such as take-or-pay concessions on the part of producers who seek to have their gas transported or satisfaction of some minimum purchase quantity standard by distributors wishing to have gas transported. If pipelines are not permitted to employ such criteria in offering transportation services, they will be forced to bear alone the risks of market loss and supply-demand imbalance that are properly shared by all sectors of the natural gas industry.

To ensure a more equitable division of the risks of marketability and supply sufficiency, the Commission should look favorably upon proposals to trade a pipeline's willingness to make transportation services more widely available for a provision permitting the collection of a take-or-pay coverage fee, such as that sought by Tennessee Gas Pipeline in a recent settlement agreement that would compensate it for absorbing carrying charges on the take-or-pay obligations it satisfies. The Commission should also entertain proposals to establish a standby charge that would compensate pipelines for maintaining reserves and capacity sufficient to serve firm customers' peak or backup supply needs as a condition for offering those customers firm transportation services. Such a charge would have elements of a demand