

NO. 14-07-00787-CV

IN THE FOURTEENTH COURT OF APPEALS
HOUSTON, TEXAS

**VIRGINIA POWER ENERGY MARKETING, INC.
and DOMINION RESOURCES, INC.,**

Appellants,

V.

APACHE CORPORATION,

Appellee.

APPEAL FROM THE 157TH JUDICIAL DISTRICT COURT
HARRIS COUNTY, TEXAS

**BRIEF OF AMICI CURIAE
SHELL ENERGY NORTH AMERICA (U.S.), L.P. AND THE NATURAL GAS
SUPPLY ASSOCIATION**

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STATEMENT OF INTEREST OF AMICI CURIAE

Amici Curiae are Shell Energy North America (U.S.), L.P. (“Shell Energy”) and the Natural Gas Supply Association (“NGSA”). Shell Energy, a natural gas marketing company which does not own any production or facilities, is an indirect wholly-owned subsidiary of Shell Oil Company. Shell Energy is the primary marketer of Shell Oil Company’s natural gas production, and it is one of the top five gas marketing companies in North America.¹

NGSA is a trade association that represents suppliers that produce and market natural gas in the United States. Established in 1965, NGSA encourages the use of natural gas within a balanced national energy policy, and promotes the benefits of competitive markets to ensure reliable and efficient transportation and delivery of natural gas and to increase the supply of natural gas to U.S. customers.

Amici Curiae urge the Court to affirm the trial court’s ruling that Apache’s contractual obligation to deliver gas was excused by the Force Majeure events of Hurricanes Katrina and Rita and that Apache was not obligated under the contract to purchase replacement gas from either the spot market or from other supply sources.

Katherine Mackillop, William Wood and Richard Wilson of the law firm of Fulbright & Jaworski prepared this brief. They will be paid by Shell Energy.

¹ Shell Energy is a party to a lawsuit in which a similar issue has arisen, confirming the importance to the industry of the proper interpretation of the Force Majeure clause. That case has been abated, and the final disposition will be affected by the Court’s opinion in this case. NGSA is not a party to that lawsuit.

SUMMARY OF ARGUMENT

Under normal conditions, the amount of natural gas flowing from production areas in the Gulf of Mexico is a huge river of gas, coming onshore to be distributed around the country. During a Force Majeure event such as a hurricane, that massive river contracts to a trickle. Despite having agreed to a Force Majeure clause which excuses both weather-related events and a subsequent failure of supply, Appellants argue that all of the gas suppliers in the Gulf must be required, as a matter of law, to compete for that trickle of gas during a Force Majeure event or risk a breach of contract judgment against them. It does not take an economics degree to figure out what will happen. Gas prices in the Gulf would rise to astronomical heights, and the available gas supply would *still* be insufficient to meet all contractual demands in the Gulf. The other option? Read the contract as written and allow the producers, sellers and purchasers to continue to do what they have done for more than 50 years—batten down during the hurricane, repair after it passes, and get the gas flowing again.

ARGUMENT

I. The Interpretation of the NAESB Form Contract Provision on Force Majeure is of Critical Importance to Natural Gas Interests in the Gulf of Mexico

A. Natural Gas Resources in the Gulf of Mexico

The Outer Continental Shelf in the Gulf of Mexico (*i.e.*, federally-controlled waters) provides 21% of the United States' natural gas. Production onshore in the Gulf

Coast region provides about another 20%. So together (onshore and offshore), the Gulf Coast provides about 40% of the nation's natural gas.²

Gulf offshore production is in either the Outer Continental Shelf (less than 200 meters deep) or in deepwater areas (more than 200 meters deep). Although shelf production has declined in recent years, increased deepwater production has kept total Gulf production steady. New discoveries continue to be made in the deepwater area. Additionally, deep drilling (15,000 feet below the mud line) on the shelf is now being explored and is considered to hold great promise for further production. Experts concur that natural gas production in the Gulf will continue to supply a significant amount of the gas consumed in the United States for the foreseeable future.

B. The Natural Gas Industry's Form Contract Contains a Force Majeure Clause

Most of the transactions for the purchase and sale of this natural gas are under an industry standard contract issued by the North American Energy Standards Board ("NAESB").³ NAESB is an independent and voluntary North American organization that develops and promotes the use of business practices and electronic communications standards for the wholesale and retail natural gas and electricity industries. Its members

² Additionally, 30% of domestically produced oil comes from offshore Gulf of Mexico.

³ The Base Contract in this case provides that New York law governs its "interpretation and performance." Base Contract at p. 1 and § 14.5 (attached as Tab A). New York law is in accord with Texas law as it pertains to Force Majeure issues. *See generally Harriscom Svenska, AB v. Harris Corp.*, 3 F.3d 576, 580-81 (2d Cir. 1993) (upholding a Force Majeure declaration based on loss of supply due to newly enacted governmental export restrictions; the court rejected an argument that the party declaring Force Majeure had to make substitute performance by purchasing supply from a supplier in another country); *see also* below at 9-13 (discussing Texas cases). Of course, the parties to similar contracts may agree on the application of the law from other states.

include over 300 companies and organizations that participate actively in the retail and wholesale natural gas and electricity markets. NAESB's predecessor, the Gas Industry Standards Board, approved the industry's first standard natural gas contract in 1996. That contract has been periodically revised by the industry through NAESB. Revisions are approved by NAESB only after extensive review of comments solicited from industry participants. *See* Press Release, North American Energy Standards Board, *Revised, Updated NAESB Standard Natural Gas Sales Contract Approved by Membership of Wholesale Gas Quadrant* (Sept. 7, 2006), available at http://www.naesb.org/pdf2/090706press_release.pdf; *see generally* www.naesb.org (attached as Tab B).

The NAESB Base Contract contains general terms and conditions applicable to all transactions between the parties. For each specific transaction, a Transaction Confirmation is generated that contains the specific terms for that transaction, including price, quantity, delivery point, delivery dates, and whether the deal is "firm" or "interruptible."⁴ The price specified in a Transaction Confirmation may be a fixed price or an index price. Index prices, which reflect market prices, are published in widely-used industry publications such as *Platt's Inside FERC* and *Platt's Gas Daily*. An index may be a monthly price or a daily (*i.e.*, spot market) price. Monthly index prices are published at the first of the month in *Platt's Inside FERC*, and daily index prices are published daily in *Platt's Gas Daily*.

⁴ "Firm" means "that either party may interrupt its performance without liability only to the extent that such performance is prevented for reasons of Force Majeure." Base Contract at § 2.17. "Interruptible," on the other hand, means "that either party may interrupt its performance at any time for any reason, whether or not caused by an event of Force Majeure, with no liability." *Id.* at § 2.20.

The Base Contract includes a Force Majeure provision, which provides that “neither party shall be liable to the other for failure to perform a Firm obligation, to the extent such failure was caused by Force Majeure.” Base Contract at § 11.1. “Force Majeure” within the meaning of the Base Contract “means any cause not reasonably within the control of the party claiming suspension, as further defined in Section 11.2.” *Id.* Section 11.2 includes a non-exclusive list of Force Majeure events, including physical events such as “hurricanes,” “weather related events affecting an entire geographic region,” and “breakage or accident or necessity of repairs to machinery or equipment or lines of pipe.” *Id.* at § 11.2.

C. Implementation of Force Majeure in the Gulf of Mexico

The hurricane season in the Gulf of Mexico begins at the first of June each year. The number and severity of hurricanes varies from year to year, but since 1998 there have been 25 hurricanes in the Gulf. Indeed, a hurricane need not be destructive to be disruptive to the gas supply. Battening down for a hurricane is not done at the flip of a switch. As a hurricane approaches the Gulf, interests in the Gulf rightly begin to evacuate and shut in production.

There can be no more striking example of the need for the Force Majeure clause than the double-whammy of Hurricanes Katrina and Rita in 2005. These hurricanes severely ravaged the Gulf Coast. First, Hurricane Katrina struck land near the Louisiana-Mississippi border on August 29, 2005. It claimed more than 1,300 lives and was the costliest hurricane in United States history, with damage estimates approaching \$100 billion. *See* Bush Administration Report at 6-7 (estimating lives lost at 1,330,

estimating damages at \$96 billion, and calling Hurricane Katrina “the most destructive natural disaster in U.S. history”) (attached as Tab C).

The extensive damage caused by Hurricane Katrina was compounded by Hurricane Rita, which struck land near the Louisiana-Texas border only 26 days later. Hurricane Rita claimed additional lives and inflicted another \$11 billion in damages, making it the sixth costliest hurricane on record. *See* NOAA Tropical Weather Summary at 11 (stating that Hurricane Rita caused 7 deaths) (attached as Tab D); NOAA Deadliest/Costliest Report at 8 (stating that Hurricane Rita caused \$11.3 billion in damages and is the sixth costliest hurricane on record) (attached as Tab E).

The devastation caused by Hurricanes Katrina and Rita stretched from East Texas all the way to Florida. The Gulf of Mexico’s natural gas infrastructure suffered unprecedented damage. An official with the United States Minerals Management Service (“MMS”), a Federal agency that manages the nation’s natural gas resources, called these hurricanes “the greatest natural disasters to oil and gas development in the history of the Gulf of Mexico.” MMS Press Release, Jan. 19, 2006 at 1 (attached as Tab F); *see also* EEA Report at 2-1 (“The combined effects of Hurricanes Katrina and Rita have had a profound effect on all sectors of the Gulf Coast natural gas industry In fact, the 2005 hurricane season is the most damaging in history.”) (attached as Tab G).

More than 75% of all Gulf oil and gas platforms and 67% of the Gulf’s 33,000 miles of pipelines were in the direct path of either Hurricane Katrina or Hurricane Rita. MMS Press Release, Jan. 19, 2006 at 1. Consequently, a staggering percentage of the Gulf of Mexico’s natural gas production remained shut-in for months. When Hurricane

Katrina struck in August 2005, 94% of all daily gas production in the Gulf was shut-in. *Id.* at 2. Almost two months later on October 31, 2005, more than 54% of the Gulf's daily gas production remained shut-in due to the hurricanes. MMS Press Release, Oct. 31, 2005 at 1 (attached as Tab H). Repair operations were extremely time consuming for a number of reasons, including the severity and extent of the damage; scarcity of resources (such as helicopters and boats); difficulty in finding people to perform repairs (many of whom had been forced out of their homes); other indirect problems such as loss of electricity and telecommunications services; and inadequate gas supplies to operate facilities.

II. The Force Majeure Clause Cannot Require Purchase of Replacement Gas During a Force Majeure Event

A. A Failure of Supply Caused by a Force Majeure Event Excuses Delivery

The Force Majeure clause excuses obligations under the contract for several reasons, two of which loom large for gas production in the Gulf. The first excuse is for natural disasters, including hurricanes. Base Contract at § 11.2(i) and (ii) (“(i) physical events such as acts of God, landslides, lightning, earthquakes, fires, storms or storm warnings, such as hurricanes, which result in evacuation of the affected area, floods, washouts, explosions, breakage or accident or necessity of repairs to machinery or equipment or lines of pipe; (ii) weather related events affecting an entire geographic region, such as low temperatures which cause freezing or failure of wells or lines of pipe”). The second excuse is for the failure of supply lines. The form contract

provides that a failure of supply caused by a Force Majeure event excuses performance. Base Contract at § 11.3(v).

These two provisions combine to require the conclusion that failure of supply caused by events such as hurricanes is itself a Force Majeure event. Section 11.3(v) provides that “[n]either party shall be entitled to the benefit of the provisions of Force Majeure” for loss or failure of Seller’s gas supply “*except* . . . as provided in Section 11.2,” the provision which includes the non-exclusive list of Force Majeure events. *Id.* (emphasis added). Therefore, pursuant to Section 11’s unambiguous language, loss of supply is excused as a matter of law *if* the loss of supply is caused by a Force Majeure event of the type listed in Section 11.2. To interpret Section 11 otherwise would render the “loss of supply” provisions in Sections 11.2 and 11.3 meaningless in violation of well-established contract construction principles. *See J. M. Davidson, Inc. v. Webster*, 128 S.W.3d 223, 229 (Tex. 2003) (courts “must examine and consider the entire writing in an effort to harmonize and give effect to all the provisions of the contract so that none will be rendered meaningless” (citation omitted)); *see also Two Guys From Harrison-N.Y., Inc. v. S.F.R. Realty Assocs.*, 472 N.E.2d 315, 318 (N.Y. 1984) (in construing a contract, courts should avoid an interpretation that would leave contractual clauses meaningless).

The failure of supply excuse is a crucial adjunct to the weather-related excuse. The vast majority of the gas in this country is not sold directly to end users. Instead, producers often sell their gas to marketing companies, which operate as large wholesalers. Marketers, such as Shell Energy, purchase gas from numerous producers

and move it to market over the interstate pipeline system. They often buy and sell gas at trading points, known as “hubs,” and ultimately deliver gas to utilities and large end use customers, who are often located far from production areas. In short, marketers act as intermediaries, and add efficiency to the markets because they balance supply and demand and optimize the use of transportation capacity. Although some gas is available in the “spot” market, because of its price it is used sparingly by purchasers. However, in the case of a severe supply disruption, such as a hurricane, the entire supply chain is disrupted, and even large marketers are unable to obtain enough gas to meet the demand. The NAESB contract is drafted to govern transactions throughout the chain for the system to function fairly and efficiently. During a Force Majeure event, suppliers and purchasers must be able to “pass along” a Force Majeure declaration to their own suppliers. Thus, a producer who is shut in because of a hurricane declares a Force Majeure excuse to its purchasers. If those purchasers are sellers to third parties, then they declare a Force Majeure event because of the hurricane and their own loss of supply. Those third parties’ contracts also likely have their own Force Majeure clause, allowing them to excuse their own non-delivery to their customers. Thus, delivery of gas slows down in an organized fashion until production and thus supply can re-start after a hurricane.

B. As a Matter of Law, the Force Majeure Clause Does Not Require Every Supplier to Compete for the Limited Gas Available on the Spot Market in the Aftermath of a Hurricane

The claim that a supplier had an obligation to secure alternative gas in the marketplace was specifically rejected by this Court in *Tejas Power Corp. v. Amerada*

Hess Corp., No. 14-98-00346-CV, 1999 Tex. App. LEXIS 6014 (Tex. App.–Houston [14th Dist.] Aug. 12, 1999, no pet.) (not designated for publication). In that case, Tejas Power Corporation (“Tejas”) sued Amerada Hess Corporation (“Amerada”), a natural gas producer, after Amerada curtailed deliveries to Tejas due to “abnormally cold weather which broadly affected gas wells within the same geographical area.” *Id.* at *8. Similar to the Base Contract at issue here, their base contract defined Force Majeure as an act of God ““or any other cause of like kind not reasonably within the [seller’s] control . . . and which, by the exercise of due diligence of such party, could not have been prevented or is unable to be overcome.”” *Id.* (alterations in original).

Tejas did not dispute that the gas shortage was caused by abnormally cold weather, but instead argued that Amerada could have, through the exercise of reasonable diligence, “overcome” the effects by purchasing replacement gas on the spot market. The *Tejas* court flatly rejected Tejas’s interpretation of the Base Contract, the same interpretation urged by Appellants here, as unreasonable:

Were we to adopt [Tejas’] interpretation . . . , Amerada’s obligation would ***never be suspended***; the force majeure clause would be ***meaningless***. So long as gas could be procured anywhere in the world, at any price, Amerada would be obliged to meet its contractual obligations.

Id. at *9 (emphases added). In reaching its conclusion, the *Tejas* court noted that while Amerada could have purchased gas on the spot market to meet its contractual commitment, “[i]t appears from the plain wording of the contract . . . that this is the very obligation that Amerada sought to avoid by inclusion of the *force majeure* clause in the contract.” *Id.* at *8-9.

Appellants here argue that if a Seller's supply line is shut down by a natural disaster, it should simply make up the difference in the spot market. But an argument that there is sufficient gas available in the spot market for one Seller to make up the difference ignores the unmistakable fact that there cannot, and will not, be sufficient gas in the spot market for every seller operating under a NAESB contract to fulfill its obligations in the spot market. Interpreting the contract to require market participants to buy replacement gas in the spot market during a Force Majeure event is unworkable because it would require all sellers to chase the same severely restricted gas supply at delivery points, resulting in a chaotic environment where prices are driven endlessly higher with no resulting increase in gas inventory. Like the popular calf scramble at the Houston Livestock Show and Rodeo, there are many more contestants than there is available supply. This is the very risk that Sellers sought to avoid through the Force Majeure provision in the NAESB form Base Contract.

C. Requiring Purchase of Gas in the Spot Market Finds No Support in the Contract Terms

1. The Seller's Gas Supply is the Supply the Seller Has Already Acquired

Grasping for support for a commercially unreasonable interpretation of the NAESB contract, Appellants claim that failure of supply cannot be a Force Majeure unless that particular supply is named in the contract. In effect, Appellants argue that "Seller's gas supply" in Section 11.3(v) does not mean the gas supply Seller actually had acquired to satisfy its contractual obligations, but instead means some hypothetical gas supply that the Seller could or might have bought, including spot market gas during the

market disruption. This interpretation would render Section 11 meaningless. For Section 11 to have any meaning, “Seller’s gas supply” is the gas supply that Seller already had contracted for delivery to Buyer. A Seller cannot be “excused” due to its loss of supply and simultaneously be obligated to secure gas from other sources of supply.⁵

2. “Reasonable Efforts” Cannot Mean the Purchase of Spot Market Gas

Failing to find support in the “gas supply” language, Appellants turn to the “reasonable efforts” language in Section 11.2 of the Base Contract, claiming it requires Sellers to find and purchase replacement gas in an already disrupted and distressed marketplace knocked out of commercial equilibrium by the Force Majeure events. Section 11.2 of the Base Contract provides that “Seller and Buyer shall make reasonable efforts to avoid the adverse impacts of a Force Majeure and to resolve the event or

⁵ Appellants’ assertion that, if a contract to supply fungible goods does not specify a source of supply, then loss of that source is not an excuse for non-performance is not supported by case law interpreting Force Majeure clauses. As Appellee notes, Br. at 24-28, the common law cases Appellants cite in support of their argument have little bearing on a contractual Force Majeure clause, because one of the purposes for agreeing on a Force Majeure provision is to contract around statutory and common law excuse doctrines. The application of a Force Majeure provision is dependent on the language used in the contract rather than statutory or common law doctrines. *See, e.g., Sun Operating Ltd. P’ship v. Holt*, 984 S.W.2d 277, 282-83 (Tex. App.—Amarillo 1998, pet. denied) (“The theory of force majeure has been existent for many years. . . . But, much of its historic underpinnings have fallen by the wayside. Force majeure is now little more than a descriptive phrase without much inherent substance. Indeed, its scope and application, for the most part, is utterly dependent upon the terms of the contract in which it appears.”) (internal citation omitted). *See also Stinnes Interoil, Inc. v. Apex Oil Co.*, 604 F. Supp. 978, 982 (S.D.N.Y. 1985) (“[I]t is clear from the case law that the parties were permitted to agree upon an excuse/suspense provision with terms broader than those of [U.C.C.] § 2-615, if that is what they chose to do.”); *see also PPG Indus., Inc. v. Shell Oil Co.*, 919 F.2d 17, 18 (5th Cir. 1990) (finding that § 2-615 was supplanted by a contractual Force Majeure provision); *InterPetrol Bermuda Ltd. v. Kaiser Aluminum Int’l Corp.*, 719 F.2d 992, 999 (9th Cir. 1983) (finding that § 2-615 was supplanted by a contractual Force Majeure provision; “it would violate fundamental principles of contract law to use section 2-615 of the U.C.C. to rewrite the contract to which the parties agreed”).

occurrence once it has occurred in order to resume performance.” Base Contract at § 11.2. This provision ensures that both parties take reasonable steps before (“reasonable efforts to *avoid* the adverse impacts”) and after (“reasonable efforts to . . . *resolve* the event or occurrence once it has occurred”) the Force Majeure event that would enable resumption of performance.

Appellants argue that the term “reasonable efforts” in Section 11.2 of the Base Contract obligates Sellers to find and secure other sources of supply, including gas available in the spot market and deliver that gas to Purchasers. But this claim contradicts the entirety of Section 11’s unambiguous language, which “excuses” performance in the event of Force Majeure from the onset of Force Majeure and for its duration. *See* Base Contract at §§ 11.1, 11.5. Here, the two hurricanes, which indisputably were Force Majeure events, disrupted and damaged Appellee’s gas supply. Appellee declared Force Majeure because of its inability to deliver gas to Appellants. This loss of Appellee’s supply of gas is a Force Majeure event as a matter of law pursuant to the unambiguous terms of the Base Contract, and this Force Majeure event relieved Appellee of its obligation to deliver gas to Appellant for the duration of Force Majeure. Base Contract at §§ 11.2, 11.3(v) & 11.5. A Seller, including Appellee, cannot be “excused” due to its loss of supply and simultaneously be obligated to secure gas from other sources of supply. This interpretation of the Base Contract urged by Appellants is not reasonable because it renders the Force Majeure provision meaningless, effectively deleting it from the Contract.

Under Appellants' interpretation, no Seller would ever be excused on the basis of Force Majeure if gas is available anywhere at any conceivable price. This asserted requirement to cover supply losses caused by a Force Majeure event at any price is the precise obligation suppliers seek to avoid through the use of a Force Majeure clause. This interpretation would mean that a Seller's obligation is *never* suspended because there is always some gas available in the marketplace, no matter how stressed the market. A Seller never would be entitled to the benefit of the Force Majeure provision and would always have to purchase replacement gas no matter the location or how high the price. The Court should decline this invitation to nullify Section 11.

Finally, no provision in the Base Contract requires Appellee to secure a new gas supply from anywhere else in the event of a "loss or failure of [its] gas supply." Base Contract at § 11.3(v); see *Helmerich & Payne Int'l Drilling Co. v. Swift Energy Co.*, 180 S.W.3d 635, 641 (Tex. App.–Houston [14th Dist.] 2005, no pet.) (stating that a court "cannot rewrite" an unambiguous contract "or add to its language under the guise of interpretation"); see also *Reiss v. Financial Performance Corp.*, 764 N.E.2d 958, 961 (N.Y. 2001) (court will not add or imply terms to an unambiguous contract under the guise of interpreting the writing). Thus, adding that contract term would violate settled contract interpretation rules.

CONCLUSION AND PRAYER FOR RELIEF

In the end, Appellants ask the Court to abandon *Tejas* and find the industry's form contract ambiguous. Declaring Force Majeure is, thankfully, not an every day occurrence. It is a decision made in crisis mode by companies in the business of

producing and selling gas, to effectively shut down their businesses (and income) for reasons and at a time not of their own choosing. The industry needs certainty, and the contract provides for it. Shell Energy and NGSA ask the Court to retain the bright-line rule that Sellers are not required to find and purchase spot market gas during a Force Majeure. Thus, Shell Energy and NGSA request that the Court affirm the trial court's judgment.

Respectfully submitted,

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