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Calculating the Price of Gas: Wet or Dry?

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Cases Considered:

Cargill Gas Marketing Ltd. v. Alberta Northeast Gas Limited, 2008 ABQB 59

When gas is sold on the basis of its thermal or heating value it is necessary to provide a formula for converting delivered volumes (Mcf) into British thermal units or equivalent. And it makes a difference whether the formula uses an assumption of wet gas or dry gas. Wet gas will have a lower heating content than dry. But what happens if the formula prescribes the use of wet gas but in fact actual deliveries under the contract have always been dry gas? This was the issue before Justice T.F. McMahon in the present case.

ANE purchased natural gas from Cargill, a gas aggregator, under the terms of two 15 year contracts. The contracts provided that the price was to be calculated on the basis of the thermal or heating value of the gas and therefore the contract contained a formula or definition for converting a volumetric measurement (Mcf) into MMBtus. The definition provided that the calculation was to be performed on the basis that the natural gas was saturated with water vapour. Since wet gas has a lower heating content than dry gas the price would be lower (by about 1.7%) than if the conversion had proceeded on the basis of dry gas. In fact the gas delivered under the contract was dry gas consistent with the standards in the industry. The parties performed the relevant calculation using the wet gas assumption from 1991 – 2004 at which point Cargill argued that since dry gas was delivered, dry gas should have been used to calculate the heating value and thus the price. Cargill argued on the basis of mistake and sought to recover damages for breach of contract, restitution and unjust enrichment.

Justice McMahon dismissed Cargill's action. There was no mistake. The contract clearly provided that the conversion from a volume basis to a heating value basis should be based on the gas as wet gas. It was untenable for Cargill to argue that the basis of the calculation should change if the gas delivered were in fact dry gas. This was because all parties knew that natural gas in pipelines had not been transported wet for decades before these contracts were negotiated. There was therefore no mistake and Cargill did not in fact allege a mistake when it first raised the issue. At the time when it raised the issue it was simply seeking to determine if there was value in re-opening the price. Even if there had been a mistake, equitable relief based on mistake or unjust enrichment might not have been warranted given that the parties had negotiated and agreed to price reductions between 1995 and 1997 and those negotiations were conducted on the basis of a wet conversion factor. Those negotiations might have proceeded very differently had ANE also been aware that Cargill would seek to recover nearly $100 million on the basis of a mistake.

The case is unlikely to be of interest outside the gas marketing business but it does stand for the proposition that the parties to a contract are free to adopt a formula for determining a key

element of the bargain that is based on a counterfactual assumption (wet gas) rather than what actually happens (dry gas). In some cases it may perhaps be difficult to convince the court that the parties really did intend to make use of a counterfactual assumption. But this was not a hard case since it had been the practice in the industry for decades to buy and sell gas of pipeline quality that would be dry gas rather than wet gas. Use of wet gas in the formula was simply a convenient assumption. And Justice McMahon was surely correct given these circumstances in finding that there was no mistake. It would be useful to have had Justice McMahon's reasons for thinking that even if there had been a mistake that equitable relief might not have been available. Was that because if there had been an enrichment that such an enrichment would not have been unjust in all the circumstances? Or was there some other reason?