I. Evolution of Natural Gas from Regulated to Unregulated Markets

A. Regulation

1. Natural Gas Act (1938). New Deal-era law to regulate interstate gas pipelines through controls on sales prices and industry entry.

3. As a result of setting the prices too low to benefit consumers, producers curtailed drilling new gas wells and widespread natural gas shortages occurred in the 1970’s.

4. Natural Gas Policy Act of 1978 was enacted to phase out price control ceiling and increase production into interstate commerce.

5. NGPA worked well and created a gas glut with interstate pipelines unable to take and market higher cost gas supplies under contracts.
6. FERC initiated Order No 436 in 1985 and then Order No. 636 (successor to earlier orders) in 1992 that changed interstate pipelines from marketers of natural gas to pure gas transporters.
B. Deregulated Gas Markets

1. Gas producing states (Texas, Louisiana and Oklahoma) all had vibrant interstate gas markets. Ohio had a “self-help” gas purchase program that had been established by the PUCO in the mid-1970’s that allowed Ohio producers to Ohio industrial and commercial customers, with the Ohio LDC’s as transporters.

2. Starting in the mid-1980s large industrial and commercial customers began to purchase natural gas from producers and marketers, under individually negotiated non-standard form gas sale and purchase agreements.
C. Drafting Considerations
Non-Standard Contracts
1. Seller Objectives.
   a. Seller wishes to maximize price, assure certainty of takes and payment from Buyer, assure certainty of delivery by utility transporters, maximize stable production and minimize contract administration burdens and expense.
2. Buyer Objectives.
   
a. Buyer (if retail) seeks to achieve substantial savings compared to utility tariff cost, assure reliable source of supply with financially stable supplier, assure delivery by utility transporters and maintain availability of suitable arrangements for “back-up” supply (tariff, alternate fuel) if Seller’s supply is interrupted.
3. General Considerations.

a. Note that in addition to general state contract law principles, a contract for the sale of natural gas (severed from realty) is a contract for the sale of “goods” under the U.C.C. (UCC Sections 2-105 and 2-107(1); Ohio Revised Code Sections 1302.01(A)(8), 1302.03(A)); Columbia Gas Transmission Corp. v. Larry H. Wright, Inc., 443 F. Supp. 1419 (S.D. Ohio 1977).
b. The significance of U.C.C. application is that Article 2 of the UCC will govern the relations between the parties, including matters such as formation, obligations under and performance of the contract, breach and remedies.
c. If the agreement is intended to require long-term obligations for both parties, it is important to take into account the extreme changes in the natural gas markets over the past years. Careful thought should be given to structuring flexibility into the contract to avoid a contract which is wholly unreflective of current market conditions.
E. Initial Client Conference

It is necessary to interview the client carefully to elicit his or her understanding of the “business deal”. It is important to inquire as to the client’s understanding of the following provisions which may or may not be contained in a draft contract and may or may not have been addressed in the contract negotiations:

1. Source of Gas Supply: intrastate or interstate, dedicated wells or non-specific “pooled” source; transportation route to Buyer; no limitation on sale by Natural Gas
(cont.)

Policy Act; any need to construct facilities to deliver supplies.

2. Obligations of Seller and Buyer to deliver and take: firm; best efforts; output/requirements; take or pay; other.

3. Price: fixed price; percentage of utility’s delivered price; spot price(s) as published by industry publication; other index; most favored nations clause; measured on volume (MCF) or heat content (MMBtu) basis; is transportation cost included in price; delivery point; renegotiation provision.
4. Term: fixed term; month to month; evergreen; right of first refusal to supply/purchase; coterminous with utility transportation or other agreements’ commencement date; date of initial deliveries.

5. Quantity: maximum, minimum, how scheduled (nominated) – on annual, monthly or other basis; critical if firm supply/purchase obligations.
6. **Delivery point (point of title transfer):** wellhead, first utility transporter’s line, local gas distribution company’s city-gate; is price specified at delivery point.

7. **Transportation and regulatory approvals:** which party responsible for obtaining; prior federal or state regulatory approval; status of transportation arrangements, failure to obtain or materially adverse changes or conditions excusing performance; responsibility for filing fees.
8. Billing/payment/credit support: net payment term; billing on basis of estimates or actual, adjustments to actual; consequence of late payment; access to books and records of parties and to transporting utility measurement and delivery statements; which measurement statement is conclusive; meter reading challenges; reasonable financial security, collateral posting.
9. Indemnity, warranty of title: generally, risk of loss transferred at delivery point, with Seller solely responsible prior to title transfer and Buyer thereafter. Specific warranty of title; consider liens, adverse claims; production/severance and other taxes.

10. Quality: Is this local gas? Gas must meet quality standards for all transporters; consequence of failure to deliver gas meeting quality specifications.
11. Force majeure: notice and full particulars; suspension of obligations; obligation to remedy; whether to specifically exclude economic conditions or Party’s ability to sell or buy gas to another at a higher or lower price from force majeure section; Party’s settlement of strikes in its sole discretion.

12. Default/remedies: notice of default and opportunity to cure; choice of remedies or silence; disclaimer of liability for loss of profits or incidental or consequential damages.
13. Notice: consider modern business practices such as email or overnight courier service.
14. Assignment: may either party assign all rights and obligations; notice requirement; consent; no consent required by changes in corporate or beneficial control or assignment to parent, subsidiary or affiliated corporation or party succeeding to party’s interest to all by purchase of assets.
E. The NAESB Contract

Industry Standard Contracts

1. In 1990, Henry Hub natural gas futures began trading on the NYMEX, necessitating more standardized gas sales and purchase contracts on a wholesale basis. The Gas Industry Standards Board then developed a standard short-term gas purchase and sales contract called the “GISB” in 1994.
2. In 2002, the North American Energy Standards Board developed a Standard Base Contract for the Sale of and Purchase of Natural Gas ("NAESB"), and revised it in 2006. Currently, it is the standard contract used for wholesale (and retail) transactions that are generally longer-term.
3. NAESB Contract is comprised of several parts:
   A. The Base Contract.
   B. General Terms and Conditions.
   C. Transaction Confirmation(s)
   D. Special Provisions
   E. Credit Support Addendum (CSA)
(See attached NAESB.)
Questions?

Glenn Krassen
Bricker & Eckler LLP
1001 Lakeside Avenue E
Suite 1350
Cleveland, Ohio 44114
gkrassen@bricker.com
216-523-5469

Shale Resource Center --
http://www.bricker.com/shale