

# FOR THE LONG HAUL: THE SUITABILITY OF THE BASE CONTRACT FOR THE SALE AND PURCHASE OF NATURAL GAS FOR LONG-TERM TRANSACTIONS

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## I. BACKGROUND<sup>†</sup>

### A. History

On April 23, 2002, the North American Energy Standards Board (NAESB) issued a press release announcing the debut of the Base Contract for the Sale and Purchase of Natural Gas (NAESB Contract).<sup>1</sup> The NAESB hailed the NAESB Contract as “[the] answer to the gas industry’s call for a contract that can be used for a wide variety of transactions, both long and short-term . . . .”<sup>2</sup>

Generally speaking, the NAESB Contract is a revised and expanded version of the Base Contract for the Short-Term Sale and Purchase of Natural Gas (GISB Contract)<sup>3</sup> which had been adopted by the Gas Industry Standards Board

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<sup>†</sup> While this article considers a number of issues associated with the use of the NAESB Contract for long-term agreements for the purchase and sale of natural gas, many of the issues analyzed are equally relevant when considering the use for long-term transactions of any of the form agreements developed for other sectors in the energy industry. For example, each of the Edison Electric Institute’s Master Power Purchase and Sale Agreement, the Western System Power Pool Agreement, and the International Swaps and Derivatives Association’s ISDA Master Agreement contain many of the same features as the NAESB Contract. Specifically, each of these contracts contains “mark-to-market” provisions for the calculation of settlement payments following an early termination similar to those found in the NAESB Contract. See part II.E of this article for a discussion of the issues surrounding the calculation of termination payments under this common formulation.

1. NAESB, BASE CONTRACT FOR THE SALE AND PURCHASE OF NATURAL GAS STANDARD 6.3.1. (Apr. 19, 2002), *available at* <http://www.naesb.org> [hereinafter NAESB CONTRACT]. The form found at the NAESB website is free to members of the NAESB and available to non-members for a nominal fee. *See also* Base Contract for Sale and Purchase of Natural Gas, <http://www.mrm.mms.gov/rikweb/PDFDocs/NAESBCon.pdf> (free version).

2. Press Release, NAESB, Contract for Purchase and Sale of Natural Gas, with Canadian Addendum, Approved by NAESB Wholesale Gas Quadrant (April 23, 2002), *available at* <http://www.naesb.org/pdf/042302pr.pdf>.

3. In fact, the NAESB Contract is essentially the GISB Contract with somewhat modest modifications. The primary modifications made to the GISB Contract to transform it into the NAESB Contract fall into the following categories: (i) additional detail for purposes of clarifying various provisions (recording procedures, provisions to address inconsistent confirmations, etc.), (ii) credit support related provisions, (iii) flexibility to insert additional provisions into a confirmation (termination options, alternate damages provisions, alternate

(GISB), the predecessor of the NAESB, and had gained widespread acceptance by the natural gas industry.<sup>4</sup> According to a disclaimer found in bold text on the first page of the GISB Contract, the GISB Contract “is intended for Interruptible transactions or Firm transactions of one month or less and may not be suitable for Firm transactions of longer than one month.”<sup>5</sup> The explanatory notes for the GISB Contract stress the intended short-term nature of the GISB Contract by stating that (i) the creation of the GISB Contract was at the request of natural gas traders to facilitate both traditional and electronic trading, and (ii) the GISB drafting committee, in preparing the GISB Contract, focused its efforts on the spot contract in order to keep the new model as simple as possible.<sup>6</sup>

Almost four and a half years after its unveiling, the NAESB Contract has lived up to its promise of being an instrument that is widely used to document both long and short-term purchases and sales of natural gas. But the question remains—is it really appropriate for long-term transactions, given its origins in the GISB’s short-term spot contract? The short answer to that question, subject to an important caveat, is YES. The important caveat is that in order to be suitable for long-term transactions, certain elections in the NAESB Contract must be made and certain special provisions must be added to the NAESB Contract in a “Special Provisions” addendum. The purpose of this Article is to provide guidance on the elections and types of special provisions that should be selected and/or added, or at least considered, when using the NAESB Contract for a long-term natural gas supply arrangement.

### *B. The Four Corners of the NAESB Contract*

The NAESB Contract is comprised of four basic parts: (i) the Base Contract for Sale and Purchase of Natural Gas (Base Contract), (ii) the General Terms and Conditions to the Base Contract for Sale and Purchase of Natural Gas (General Terms), (iii) one or more transaction confirmations (Confirmation), and (iv) a special provisions addendum (Special Provisions Addendum).<sup>7</sup> Based on these four component parts, the NAESB Contract is designed (a) such that either party may, at any given time, be a purchaser or a seller of the natural gas in question and (b) to establish a general “trading framework” between the parties whereby the standard contracting terms and conditions for the on-going relationship between the parties are agreed in the Base Contract, the General Terms, and the Special Provisions Addendum.<sup>8</sup> Once this general framework has been established, the parties can then, from time to time, enter into actual transactions

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force majeure provisions, etc.), (iv) netting-related provisions to allow offsetting between various different transactions among the parties and (v) a more detailed procedure for the determination of a “Net Settlement Amount” and how and when it is payable. NAESB Contract, *supra* note 1.

4. See also William P. Boswell & James P. Cargas, *Legal and Administrative Underpinnings of a Consensus Based Organization*, 27 ENERGY L.J. 147 (2006) (description of the transformation of the GISB into the NAESB and the legal and administrative underpinnings of the NAESB).

5. GISB, BASE CONTRACT FOR SHORT-TERM SALE AND PURCHASE OF NATURAL GAS STANDARD 6.3.1 (Jan. 7, 2000), available at [http://www.cers.water.ca.gov/pdf\\_files/other\\_contracts/natural\\_gas\\_ctrcts/070101\\_texaco\\_natural\\_gas\\_inc.pdf](http://www.cers.water.ca.gov/pdf_files/other_contracts/natural_gas_ctrcts/070101_texaco_natural_gas_inc.pdf).

6. GISB, BASE CONTRACT FOR SHORT-TERM SALE AND PURCHASE OF NATURAL GAS EXPLANATORY NOTES (Feb. 13, 1996).

7. NAESB CONTRACT, *supra* note 1.

8. *Id.*

evidenced by Confirmations identifying the specifics of a particular transaction for the purchase and sale of natural gas, *e.g.*, setting forth the quantity, the price, and the delivery and receipt points for the natural gas being purchased and sold.<sup>9</sup>

Prior to the effectiveness of a Confirmation, neither party is under any obligation to buy natural gas from, or sell natural gas to, the other party. There is no limit to the number of Confirmations that the parties may execute in connection with a NAESB Contract; thus, they may engage in multiple transactions on the same general terms and conditions but with different specifications for the actual purchase and sale of natural gas. In fact, one party can be a buyer under one Confirmation and a seller under a different Confirmation, and *vice versa*. These flexible features of the NAESB Contract have their roots in the short-term spot trading context that spawned the GISB Contract which, as mentioned above, was developed at the request of natural gas traders to facilitate their execution of transactions for the purchase and sale of natural gas in a fluid and timely manner.<sup>10</sup>

### C. Long-Term vs. Short-Term Interests

In order to understand why it is important to consider whether the NAESB Contract is appropriate for long-term transactions despite its origins in a short-term spot contract, it will first be essential to explore some of the intrinsic differences between long- and short-term transactions and the motivations and interests of the parties entering into them. In a short-term spot transaction, the parties are focused on a one-time acquisition or sale of natural gas at a given price.<sup>11</sup> In addition, typically the period of time between reaching an agreement on the terms of a spot transaction and the actual execution of the transaction is very close at hand, usually within hours or days. As a result, parties involved in spot contracts are more interested in being able to execute a transaction swiftly than in protecting interests and addressing issues that could arise over a more extended period of time.<sup>12</sup> In the event that a transaction is not executed as originally contemplated, the buyer or seller will likely acquire, or sell, the natural gas in question on the spot market from another seller or to another buyer, as applicable. Thus, so long as they are properly compensated for any incremental expenses or losses suffered with respect to an alternate transaction, at the end of the day, the parties will be satisfied.

Parties to a long-term contract, however, generally have entered into such an arrangement in order to secure a long-term supply of, or market for, natural gas at a certain price. Simply liquidating a transaction and being reimbursed for any expenses or losses incurred with respect to a failure to perform will likely not be entirely satisfactory to the performing party as it is likely to have long-term obligations on which it depends on timely deliveries or sales of natural gas

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9. NAESB CONTRACT, *supra* note 1.

10. *Id.*

11. John A. Rosenkranz, *Risk Management Principles in Natural Gas Marketing*, 122 PUB. UTIL. FORT. 27 (1988) [hereinafter Rosenkranz]; Richard J. Pierce, *Reconsidering the Role of Regulation and Competition in the Natural Gas Industry*, 97 HARV. L. REV. 345 (1983) [hereinafter Pierce].

12. Rosekranz, *supra* note 11, at 29.

and will need to find some type of comparable replacement arrangement.<sup>13</sup> In addition, the likelihood that circumstances will change or some event may take place that could adversely affect a party's ability to perform, or implement the provisions of the contract, over time is much greater the longer the term of a contract.<sup>14</sup> Thus, a long-term contract will need to address these potential eventualities and the parties to a long-term agreement will be more focused on ensuring that the relevant contractual documentation is designed to protect the rights of the parties in the long-run, possibly years after the parties have reached agreement on the transaction.<sup>15</sup> As previously mentioned, such protections would not be required in a short-term spot contract like the GISB Contract, which is why it is important to consider carefully the various options and additions to be incorporated into a NAESB Contract intended for use with long-term transactions.

## II. RECOMMENDED OPTIONS IN THE BASE CONTRACT FOR THE LONG-TERM

Both the Base Contract and the General Terms portions of the NAESB Contract contain a number of provisions that either (i) contain two or more distinct options requiring the parties to select one or (ii) allow the parties to change or supplement a provision with insertions or modifications included in the relevant Confirmation or Special Provisions Addendum, as applicable.<sup>16</sup> As some of these options are better suited than others to long-term contractual arrangements, it will be very important that parties seeking to use the NAESB Contract for a long-term transaction make the appropriate selections. This section of the Article highlights (in the general order of occurrence of the provisions in the Base Contract and the General Terms) those provisions that require such a selection, or contemplate such adjustments, and makes recommendations as to the more appropriate selections for a long-term arrangement.

### A. *Written Transaction Procedure*

Section 1.2 of the Base Contract presents the first election that must be made in the NAESB Contract. The option selected in this section will determine whether or not Confirmations for transactions will be done by way of an "Oral Transaction Procedure" or a "Written Transaction Procedure."<sup>17</sup> The primary difference between the two options boils down to whether or not a written confirmation memorializing a transaction between the parties will be required.

For purposes of using the NAESB Contract to effect a Confirmation for a long-term transaction, the selected transaction procedure should be the "Written Transaction Procedure."<sup>18</sup> While the oral transaction option does contemplate

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13. Pierce, *supra* note 11, at 354-57.

14. For example, the likelihood that a pricing index will not be available in an hour to fix the price of a spot sale of natural gas is unlikely; however, for a transaction of ten years or more, such a possibility does become more likely.

15. Rosenkranz, *supra* note 11; Pierce, *supra* note 11.

16. NAESB CONTRACT, *supra* note 1.

17. *Id.* § 1.2.

18. NAESB CONTRACT, *supra* note 1, § 1.2.

the delivery of a written confirmation, the delivery of a written confirmation is not required to establish a binding contract.<sup>19</sup> Oral agreements may be acceptable, and even in some cases desirable, in the context of a short-term contract relating to a spot delivery of natural gas where speed of transaction execution is paramount and the full execution of the transaction occurs close in time to the oral Confirmation. In these circumstances, the risk of a dispute is somewhat limited and, in the event a dispute does arise, the details of the transaction should be relatively fresh in the parties' minds. However, in the long-term context, the extended time frame makes the risks inherent in oral agreements untenable: with the passage of time, the risk of a dispute arising will increase and the recollection of transaction details by the parties will fade. In the event that there is a disagreement a year or more down the road, the parties will want, and likely need, the clear evidence of the terms of their agreement available from a written Confirmation.<sup>20</sup>

### *B. Cover Standard*

Section 3.2 of the Base Contract requires the parties to a NAESB Contract to elect between a "Cover Standard" or a "Spot Price Standard" to govern the calculation of damages in the event that a party fails to perform its contractual obligations.<sup>21</sup> The difference between these two options has to do with the obligation the performing party takes on in the event of the other party's failure to perform. If the parties elect the Cover Standard, the performing party is required to use commercially reasonable efforts to find a replacement buyer or seller of natural gas, as applicable. The performing party is then entitled to damages equal to the difference in the price of the natural gas either purchased from the replacement supplier or sold to the replacement buyer and the contract price ("adjusted for commercially reasonable differences in transportation costs") multiplied by the total quantity of natural gas bought or sold in the replacement transaction.<sup>22</sup> In the event that a performing party is unable to obtain replacement natural gas supplies or find a replacement buyer of natural gas, as applicable, the performing party will be entitled to damages calculated based on the Spot Price Standard. The Spot Price Standard entitles the performing party to the difference between the contract price and the spot price of natural gas as determined by reference to a pre-selected published index ("adjusted for commercially reasonable differences in transportation costs") multiplied by the total quantity of natural gas that was not duly delivered or purchased in accordance with the relevant transaction Confirmation.<sup>23</sup>

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19. 9 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 21:4 (4th ed. 2002) [hereinafter 9 WILLISTON]; 2 E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS §§ 7.2–3 (3d ed. 2004) [hereinafter 2 FARNSWORTH].

20. *In re Aurora Natural Gas, LLC v. Texas E. Transmission Corp.*, 316 B.R. 481, 484 (Bankr. N.D. Tex. 2004) (referencing the lack of written confirmations evidencing the transactions in question as one of the factors precluding the grant of a summary judgment motion due to the existence of genuine issues of material fact).

21. NAESB CONTRACT, *supra* note 1, § 3.2.

22. *Id.* § 3.2.

23. NAESB CONTRACT, *supra* note 1, § 2.26.

For a long-term contract, the Cover Standard is preferable for two reasons. First, it replicates what a buyer or seller of a product would rationally do in the case of a default if the buyer or seller is motivated by securing a long-term supply or purchaser of a product, that is, find a replacement source or buyer. Second, utilization of the Spot Price Standard would run the risk that the chosen spot price index could either be abnormally high or low at the particular time of calculation and yield a damages figure that does not either sufficiently compensate the damaged party or, alternatively, results in a windfall to such party.<sup>24</sup>

Notwithstanding these short-comings, the Spot Price Standard is well suited for application in short-term spot contracts because it effectively immediately liquidates the unperformed obligation. As highlighted earlier, parties to a spot agreement typically are only concerned about the transaction at hand and will be keen to simply liquidate any failed transaction immediately.

### C. *Alternative Damages*

One of the additions to the NAESB Contract as compared to the original GISB Contract is section 3.3 of the General Terms, which explicitly contemplates that the parties can specify “Alternative Damages” in a Confirmation.<sup>25</sup> Parties using the NAESB Contract to memorialize a long-term contract may want to consider embellishing or replacing the Cover Standard or Spot Price Standard with their own formulation as to the measure of damages that should apply with respect to a failure by one of the parties to perform.<sup>26</sup> This is particularly important given that section 13 of the NAESB Contract unequivocally limits the liability of each party to only those direct damages specifically contemplated by the NAESB Contract or otherwise made applicable to a transaction (*i.e.* pursuant to a Confirmation or a Special Provisions Addendum).<sup>27</sup> Thus, unless specifically contemplated in an “Alternative Damages” provision (or otherwise), any indirect or consequential damages, such as legal fees and/or transaction costs would not be recoverable by a party, as such costs would not be included in the damages calculation under either the Cover Standard or the Spot Price Standard, both of which focus solely on pricing differentials of the natural gas in question.<sup>28</sup>

As a result, in order for a party to recover these types of damages, it would be important to add to the measure of damages any incremental transaction costs, including legal expenses, incurred in finding a replacement supplier or buyer of natural gas. In addition, if the buyer has entered into a long-term NAESB Contract in order to support obligations that it may have to generate and sell electricity under a long-term power sales agreement or other similar obligations, such buyer may want to consider including, in an “Alternative Damages” provision, any damages that it may incur under such power sales agreement or

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24. 24 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 66:44 (4th ed. 2002) [hereinafter 24 WILLISTON].

25. NAESB CONTRACT, *supra* note 1, § 3.3.

26. 24 WILLISTON, *supra* note 24, § 64:12.

27. NAESB CONTRACT, *supra* note 1, § 13.

28. *Id.*

other arrangement for the failure to perform due to the lack of adequate natural gas supplies.

#### *D. Termination Option*

Another provision added to the NAESB Contract is section 3.4 of the General Terms. This provision allows the parties to include in a Confirmation a “Termination Option” giving the performing party an option to terminate and liquidate the relevant transaction as the result of the other party’s failure to perform. This is an important provision for those parties, specifically buyers, seeking to use the NAESB Contract in a long-term context because, as will be noted later, section 10.2 of the General Terms relating to Events of Default does not include the failure to deliver natural gas in accordance with the NAESB Contract as an Event of Default which could justify early termination of the contract by a performing buyer.<sup>29</sup>

To protect the interest of a buyer seeking to secure a long-term supply of natural gas, it is critical that the buyer insist on either including a detailed Termination Option in the Confirmation relating to the seller’s failure to deliver natural gas as contemplated by section 3.4 of the General Terms. Or, as discussed below in part III.A, the buyer could modify section 10.2 of the General Terms (relating to Events of Default) in a Special Provisions Addendum to include a seller non-performance related Event of Default. If a long-term buyer does not take such steps, it may find itself unable to terminate a long-term contract, even though it is not receiving the natural gas it needs, if the non-performing seller continues to pay either the Cover Standard or Spot Price Standard measure of damages, as applicable, in a timely manner. Although the payment of those damages theoretically could keep the performing buyer financially whole, it would not ensure the long-term supply of natural gas and certainty as to gas availability initially sought by the buyer.

#### *E. Early Termination Damages Apply*

In order to provide the parties to a long-term contract with the incentive to perform their obligations for the full length of the agreement, it is important that (i) a defaulting party be subject to an appropriate measure of damages for its non-performance that takes into account the full remaining term of the agreement in question and (ii) the non-defaulting party not be subject to penalty for its election to terminate the agreement and exercise the applicable remedies. Thus, against that background, a critical selection for parties to make if they intend to use the NAESB Contract in a long-term context is the option in section 10.3.1 of the Base Contract stipulating that Early Termination Damages Apply.<sup>30</sup>

The selection of section 10.3.1 provides for a “Net Settlement Amount”<sup>31</sup> (a termination payment) to be paid with respect to (i) any performed and unsettled transactions and (ii) any transactions remaining unperformed as of the date of an

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29. 2 FARNSWORTH, *supra* note 19, § 8.15.

30. NAESB CONTRACT, *supra* note 1, § 10.3.1.

31. NAESB CONTRACT, *supra* note 1, § 10.3.1. The Net Settlement Amount is the amount determined by aggregating and netting into a single liquidated amount all amounts owing between the parties based on the calculation of the ‘contract value’ and ‘market value’ of the remaining transactions. *Id.*

early termination caused by an Event of Default on the part of the defaulting party. However, an important word to the wise: the Early Termination Damages provision contained in Section 10.3.1 of the General Terms is designed such that the Net Settlement Amount may be paid by either party to either party, depending on whether the market value of the remaining transactions at the time is more or less than the remaining contract value, regardless of which of the parties is the defaulting party.<sup>32</sup> As a result, it could in fact be the case that the defaulting party could be entitled to receive the termination payment.<sup>33</sup>

The mechanism contained in section 10.3.1 of the General Terms to calculate the Net Settlement Amount contemplates the liquidation of the unperformed portion of the NAESB Contract and the calculation of (x) the “contract value” of the unperformed portion of each of the outstanding transactions and (y) the “market value” of the unperformed portion of each of the outstanding transactions. The “contract value” is a function of the remaining volumes of natural gas to be delivered or purchased under the agreement and the contract price, and the “market value” is a function of the remaining volumes of natural gas to be delivered or purchased and the “market price,” which is based on the then current market price of natural gas for a comparable transaction at the relevant delivery point, determined in a commercially reasonable manner.<sup>34</sup> The “contract value” and “market value” are then discounted to the early termination date in a commercially reasonable manner. In the event the contract value exceeds the market value, the seller would be entitled to receive payment of the “Net Settlement Amount” and in the event the market value exceeds the contract value, the buyer would be entitled to receive payment of the “Net Settlement Amount.”<sup>35</sup> Although this formulation is a typical formulation used in trading contracts since short-term traders are only concerned with the liquidation of the transactions against current market standards, as noted in part III.B below, in a long-term relationship, it would be preferable to use the Special Provisions Addendum to amend this provision such that the non-defaulting party

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32. *Mirant Americas Energy Marketing v. City of Vernon*, 319 B.R. 489 (Bankr. N.D. Tex. 2004). The application of similar provisions found in various energy sales contracts is also the subject of a number of legal proceedings involving Enron Corporation and its bankrupt affiliates. Generally, these cases involve: (i) the early termination of a contract by the applicable counterparty because of Enron’s actual bankruptcy filing (or impending filing and failure to provide requested credit support), and (ii) the bringing of an adversary proceeding by Enron’s bankruptcy estate seeking the payment of substantial settlement amounts allegedly due in Enron’s favor under the applicable agreements—based on the market vs. contract pricing at the time of termination. *See also In Re Enron Power Marketing, Inc. v. City of Santa Clara*, 2003 U.S. Dist. Lexis 189 (S.D.N.Y. Jan. 8, 2003); *In Re Enron Corporation et al. v. Holcim, Inc.*, 2004 U.S. Dist. Lexis 19131 (S.D.N.Y. Sept. 22, 2004).

33. *See, e.g., Mirant Americas Energy Marketing*, 319 B.R. 489 (holding that the non-defaulting party to a Western System Power Pool Agreement (a form contract for the delivery of power) was, in fact, required to pay a termination payment to the defaulting party, as per the clear wording of the contract.); *see also In Re Enron Power Marketing, Inc.*, 2003 U.S. Dist. Lexis 189 (referencing a general principal of New York law that contracts between sophisticated parties will be interpreted as clearly written).

34. “To ascertain the Market Value, the Non-Defaulting Party may consider, among other valuations, any or all of the settlement prices of NYMEX Gas futures contracts, quotations from leading dealers in energy swap contracts or physical gas trading markets, similar sales or purchases and any other bona fide third-party offers, all adjusted for the length of the term and differences in transportation costs.” NAESB CONTRACT, *supra* note 1, § 10.3.1.

35. *Id.*

is not liable for termination payments even in the case where the market valuation would indicate that it should be.<sup>36</sup>

The other available option in section 10.3.1 of the Base Contract, Early Termination Damages Do Not Apply, would result in a termination payment being paid with respect to any performed parts of the transactions which have not yet been settled, but not with respect to any future performance obligations that had not yet been performed. In the case of a long-term arrangement, election of this option would be disastrous, as it would eliminate any incentive for the parties to continue to perform, given that their only liability for breach would be the settlement of any part of the transaction which had already been performed.

#### *F. Other Agreement Setoffs Do Not Apply*

Section 10.3.2 of the Base Contract permits the parties to choose between two different setoff mechanisms. The primary difference between the two options is that, under the Other Agreements Setoffs Do Apply framework, the non-defaulting party may offset a Net Settlement Amount due by it to the defaulting party against any amounts due to it by the defaulting party—either under the applicable NAESB Contract or any other agreement between the parties. Thus, in the event that the parties both (i) elect that Early Termination Damages Apply in section 10.3.1 of the Base Contract and (ii) amend section 10.3.1 of the General Terms as recommended in part III.B below, then the parties should elect in section 10.3.2 of the Base Contract that Other Agreement Setoffs Do Not Apply. This election is appropriate because the Other Agreement Setoffs Apply option would no longer have any meaningful effect since it would no longer be possible for a Net Settlement Amount to be payable to a defaulting party. While this selection is not altogether necessary in the sense that a failure to make this selection would not compromise the integrity of a long-term natural gas arrangement based on the NAESB Contract, it does make for a cleaner and more internally consistent agreement.

#### *G. Alternative Force Majeure Provisions*

Section 11.6 of the General Terms allows the parties to incorporate alternative Force Majeure provisions into a Confirmation. Although the NAESB Contract does contain a fairly broad definition of “Force Majeure,”<sup>37</sup> subject to

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36. Rosenkranz, *supra* note 11; Pierce, *supra* note 11.

37. Force Majeure means any cause not reasonably within the control of the party claiming suspension as further defined in Section 11.2. Section 11.2 provides that Force Majeure shall include, but not limited to, the following: “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; (iii) interruption and/or curtailment of [f]irm transportation and/or storage by [t]ransporters; (iv) acts of others such as strikes, lockouts or other industrial disturbances, riots, sabotage, insurrections or wars; and (v) governmental actions such as necessity for compliance with any court order, law, statute, ordinance, regulation, or policy having the effect of law promulgated by a governmental authority having jurisdiction. Seller and Buyer shall make reasonable efforts to avoid the adverse impacts of a [f]orce [m]ajeure and to resolve the event or occurrence once it has occurred in order to resume performance.” NAESB CONTRACT, *supra* note 1, § 11.2.

certain customary (and not-so-customary) exclusions,<sup>38</sup> and fairly customary procedural requirements<sup>39</sup> for a party seeking relief from its obligations as the result of an event of Force Majeure, parties contemplating the use of the NAESB Contract for a long-term transaction may want to consider modifying the definition and related exclusions to address two specific concerns.

On the side of the buyer, one of the not-so-customary exclusions specified in section 11.3 of the General Terms is “the loss of Buyer’s market(s) *or Buyer’s inability to use . . .*” (emphasis added).<sup>40</sup> This limitation to the NAESB Contract’s Force Majeure definition makes a great deal of sense, and is almost a necessity to avoid giving a buyer an unfair advantage when two natural gas traders, whose entire business strategy revolves around the risks of being able to buy and sell natural gas at a profit, are involved. However, the impact of this limitation will be quite different in the context of a buyer who is a power producer or other industrial concern, purchasing natural gas for the long-term solely for purposes of fueling its power generating facilities or other industrial facilities, particularly if such buyer is bound to sell 100% of its electricity or other output pursuant to a long-term sales agreement. In such a scenario, the buyer would be obligated to accept natural gas deliveries under the NAESB Contract (or pay damages for its failure to do so) even if an event were affecting the power generation assets (or the transmission grid) or other assets in such a manner that either the buyer itself or the purchaser of buyer’s electrical energy or other output is excused from its respective obligations under the relevant documentation. As a result, such a buyer could end up receiving natural gas for which it has no use (or paying damages if it refuses delivery) and for which it may not be paid or reimbursed by way of sales of its output, unless it has the ability to sell the natural gas to another party or to sell its electrical energy or other output to another party.

On the seller’s side, a seller who is a natural gas marketer that has entered into a long-term supply arrangement with a power producer or other industrial concern may want to consider adding to the exclusions contained in section 11.3 of the General Terms a provision excluding from the definition of Force Majeure technical and mechanical failures of the buyer’s power generating equipment (or the electrical output grid) or other industrial facilities. Such a provision would be of particular interest to a natural gas trader whose business revolves around purchasing from third parties all of the natural gas that it is obligated to sell

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38. Section 11.3 of the General Terms provides that neither party shall be entitled to the benefit of the provisions of Force Majeure to the extent performance is affected by any or all of the following circumstances: “(i) the curtailment of interruptible or secondary [f]irm transportation unless primary, in-path, Firm transportation is also curtailed; (ii) the party claiming excuse failed to remedy the condition and to resume the performance of such covenants or obligations with reasonable dispatch; . . . (iii) economic hardship, to include, without limitation, [s]eller’s ability to sell [natural] [g]as at a higher or more advantageous price than the [c]ontract [p]rice, [b]uyer’s ability to purchase [natural] [g]as at a lower or more advantageous price than the [c]ontract [p]rice, or a regulatory agency disallowing, in whole or in part, the pass through of costs resulting from this [a]greement; (iv) the loss of [b]uyer’s market(s) or [b]uyer’s inability to use or resell [natural] [gas] purchased hereunder, except, in either case, as provided in Section 11.2.” NAESB CONTRACT, *supra* note 1, § 11.3. The party claiming Force Majeure shall not be excused from its responsibility for imbalance charges. *Id.* § 11.3.

39. NAESB CONTRACT, *supra* note 1, § 11.1.

40. *Id.* § 11.3(iv).

under a NAESB Contract. By including such a provision, such a seller will avoid the risk of expending funds to purchase natural gas that the buyer would not be obligated to accept and for which the buyer would not be obligated to reimburse the seller under the NAESB Contract as the result of the occurrence of an event that would qualify as an event of Force Majeure.

### III. RECOMMENDED SPECIAL PROVISIONS FOR THE LONG-TERM

In addition to selecting the various options found in the Base Contract and the General Terms in the manner described above, it will be important to attach a Special Provisions Addendum in order to transform the NAESB Contract into a contract suitable for long-term natural gas supply arrangements. The proposed special provisions to be included on the Special Provisions Addendum take two shapes: (i) those that seek to amend certain of the existing General Terms and (ii) those that seek to incorporate new provisions into the General Terms.<sup>41</sup>

As mentioned in part II., *supra*, the General Terms do occasionally offer the parties the option of including replacement or alternative provisions in a transaction Confirmation. Generally speaking, if there is a choice between inserting a special provision in a Confirmation, or amending or inserting a provision by way of a Special Provisions Addendum, it would be preferable to use the Special Provisions Addendum, because through this mechanism the special provision will apply to all Confirmations executed in connection with the applicable NAESB Contract. If, however, the parties intend to use a NAESB Contract to effect one long-term transaction pursuant to one (and no more than one) Confirmation, there would be no substantive difference in approach.

#### A. Events of Default

Interestingly, while the NAESB Contract did make a number of changes to the provisions contained in section 10 of the original GISB Contract, these changes did not go quite far enough to make the General Terms, standing alone, sufficient for purposes of documenting a long-term contractual arrangement. Specifically, the identified list of Events of Default contained in section 10.2 of the General Terms remains almost identical to that contained in the GISB Contract.<sup>42</sup> The listed Events of Default relate almost exclusively to bankruptcy events and to the failure to make payments due under the NAESB Contract.<sup>43</sup> There are no other performance-related Events of Default included in the General Terms. In the context of a short-term trading contract, this approach—limited to payment failures and other credit difficulties—would be sufficient to protect the interests of the short-term trader whose primary concern is either being paid for the natural gas that was supposed to be purchased or sold or being reimbursed under section 3.2 of the General Terms pursuant to the Cover Standard or the Spot Price Standard, as appropriate.<sup>44</sup>

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41. NAESB CONTRACT, *supra* note 1 (special provisions addendum).

42. There were two noteworthy additions to the NAESB Contract relating to (i) a failure to perform or post any Credit Support Obligations and (ii) a failure to provide adequate assurance when requested in accordance with section 10.1 of the General Terms. NAESB CONTRACT, *supra* note 1, § 10.2.

43. *Id.*

44. NAESB CONTRACT, *supra* note 1, § 3.2.

In the short-term context, if one party develops serious concerns regarding the ability of the other party to supply the requisite natural gas or pay for the natural gas delivered, as the case may be, such party can simply opt not to enter into any further transactions pursuant to additional Confirmations under a NAESB Contract with that supplier or purchaser and obtain its natural gas needs from other sources, or sell its natural gas supplies to other purchasers, as the case may be. However, once the parties have entered into a Confirmation for a long-term transaction under a NAESB Contract, that solution is no longer adequate. Unless the Confirmation relating to such transaction contains a performance-related "Termination Option" as permitted by section 3.4 of the General Terms, once the parties have executed such a long-term Confirmation, both parties are bound to perform for the required duration of such Confirmation, unless there is an actual payment default or bankruptcy.<sup>45</sup> The NAESB Contract as written does not include a right for a party to terminate the contract early in the event that the other party fails to perform any obligation aside from its payment obligations.<sup>46</sup> Thus, where a buyer is interested in using the NAESB Contract for purposes of securing a long-term supply of natural gas, it will be critical that it either: (i) include in the Confirmation for that transaction a termination procedure with an appropriate provision for damages in the event that the supplier fails to deliver the scheduled natural gas for a certain period of time, or (ii) amend section 10.2 of the General Terms, pursuant to a Special Provisions Addendum, to include as an Event of Default the failure of the seller to perform its obligations under the contract other than payment-related ones for a certain period of time.<sup>47</sup>

In addition to adding an Event of Default relating to the seller's failure to perform, parties utilizing the NAESB Contract for a long-term transaction may want to consider adding other Events of Default to section 10.2 of the General Terms, as well. Other Events of Default to consider are: (i) material breach of a representation or warranty by either party, (ii) loss of any required regulatory approvals required for either party to perform under the contract, (iii) a default under any other agreement between the parties that results in an acceleration of the obligations under such agreement or termination of such agreement, (iv) a default under one or more agreements or instruments relating to the indebtedness of a party or its guarantor over a certain threshold, (v) the entry of any judgment in excess of a certain threshold against a party or its guarantor, (vi) the occurrence of any merger or similar transaction affecting a party or its guarantor following which such party's or its guarantor's obligations are not duly and completely assumed by a credit-worthy surviving entity, and (vii) the change of control of the ownership of a party. These additional Events of Default are desirable for purposes of monitoring and ensuring the on-going performance of a counterparty to a long-term contract.<sup>48</sup> They are designed to provide an early warning system to forewarn a party of the occurrence of an event which may

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45. *Id.* § 3.4.

46. NAESB CONTRACT, *supra* note 1, § 10.2.

47. *See, e.g.*, 2 FARNSWORTH, *supra* note 19, § 8.15.

48. *See, e.g.*, 15 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS §§ 43:24, 43:29, 43:30 (4th ed. 2002) [hereinafter 15 WILLISTON]; *see also* 2 FARNSWORTH, *supra* note 19, § 8.20.

compromise the other party's ability to perform its obligations in the long run. If one of these early warnings is triggered and a non-defaulting party has serious concerns about its defaulting counterparty's ability to perform, it could declare an Event of Default, terminate the agreement and possibly recover damages before the counterparty becomes truly incapable of performance.<sup>49</sup> While these additional Events of Default will provide valuable protections in the context of a long-term transaction where a party's creditworthiness or other fortunes may fluctuate over time in a manner not likely with a short-term spot contract, they are not, from the buyer's perspective, nearly as critical as the addition of a Termination Option or Event of Default relating to the seller's general performance of obligations other than those relating to payment would be.

### *B. Termination Damages*

As mentioned in part II.E, *supra*, sections 10.3.1 and 10.3.2 of the General Terms contain a mechanism whereby a "Net Settlement Amount" is payable by one party or the other, depending on the "market value" of the unperformed transactions at the time of an early termination. This provision is designed such that either the defaulting or non-defaulting party may be required to pay the relevant settlement amount.<sup>50</sup>

In the long-term context, the parties should use the Special Provisions Addendum to amend sections 10.3.1 and 10.3.2 of the General Terms such that the Net Settlement Amount is only payable by the defaulting party. This suggested amendment is particularly important if one of the parties plans to obtain financing supported by the terms of the NAESB Contract and related commercial arrangements. While typically a financier will take the default risk and attendant consequences of its own borrower, it is generally unwilling to take on the risk that its borrower may become liable for a termination payment even when it is not the defaulting party.

### *C. Credit Support*

The General Terms do not expressly contemplate the provision of credit support by the parties, aside from acknowledging their right to "demand adequate assurance"<sup>51</sup> in situations where "reasonable grounds for insecurity"<sup>52</sup> exist. While this casual approach to the matter of credit support may be appropriate for short-term arrangements where the overall credit exposure of the parties is limited by the short duration of the contract, it is not adequate for purposes of long-term arrangements where (i) the credit exposure over the course of several years could be significant and (ii) a change in the credit quality of a counterparty becomes more likely due to the passage of time. Thus, in the context of a long-term arrangement, the adequate assurance provision of section 10.1 of the General Terms is of limited benefit. The primary weakness of this provision is that the party demanding adequate assurance must first demonstrate

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49. 2 FARNSWORTH, *supra* note 19, § 8.20.

50. NAESB CONTRACT, *supra* note 1, § 10.3.

51. *Id.* § 10.1.

52. NAESB CONTRACT, *supra* note 1, § 10.1.

that “reasonable grounds for insecurity” exist.<sup>53</sup> While various jurisdictions have interpreted this requirement differently, it is possible in more conservative jurisdictions that the relief afforded by this clause may come too late, as the party being requested to post adequate assurance may no longer have the requisite credit quality to obtain acceptable credit support for the same reasons that gave rise to such “reasonable grounds” in the first place.<sup>54</sup> As a result, if parties are planning to use a NAESB Contract for a long-term relationship, they should consider supplementing the NAESB Contract with appropriate credit support requirements.

Ultimately, the NAESB recognized that parties interested in long-term relationships generally desire a more comprehensive credit support framework that is designed to provide comfort before it was too late. Thus, in October 2003, the NAESB published a form Credit Support Addendum (CSA)<sup>55</sup> that sets forth a complex framework of options among which the parties to a NAESB Contract can choose credit support arrangements that are appropriate for each of the parties.

In a nutshell, the CSA is designed such that either party may be required to post collateral once a certain minimum exposure threshold has been crossed by such party. The minimum exposure threshold can either be a flat monetary amount that would be due and owing by a party as of any given date if the “Net Settlement Amount” were to be calculated as of such date (assuming termination of the NAESB Contract as of such date), or by way of reference to a matrix relating to the rating of the long-term unsecured debt of a party.<sup>56</sup> The CSA contemplates various types of collateral being posted (*e.g.*, cash, letters of credit, or guaranties) and sets minimum amounts of collateral that can be transferred at any given time. The CSA also includes a mechanism whereby posted collateral may be replaced or released upon the satisfaction of certain conditions.

In addition to determining the various details for the posting of collateral (*e.g.*, type, minimum exposures, and minimum transfer amounts), if the parties opt to use the CSA, they have a choice between two options with respect to the timing of the posting, substitution and/or release of collateral. Option A requires collateral to be posted, reduced, or substituted on the business day following a demand or request and Option B allows the parties to select their desired time frame.<sup>57</sup>

The complexity and flexibility offered by the CSA is ideal for natural gas traders who could be either buyer or seller under the terms of a NAESB Contract because it can provide for a constant adjustment of posted collateral based upon the relative outstanding exposure one party has with respect to the other based upon the calculation of the “Net Settlement Amount” that could be payable by

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53. 15 WILLISTON, *supra* note 48, §§ 43:18, 43:22; 23 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 63:41 (4th ed. 2002); Larry T. Gavin, *Adequate Assurance of Performance: Of Risk, Duress, and Cognition*, 69 U. COLO. L. REV. 71, 118 (1998); *Norcon Power Partners v. Niagara Mohawk Power Corp.*, 705 N.E.2d 656, 660 (N.Y. 1998).

54. *Norcon Power Partners*, 705 N.E.2d at 660.

55. NAESB, MODEL CREDIT SUPPORT ADDENDUM TO THE BASE CONTRACT FOR SALE AND PURCHASE OF NATURAL GAS ADOPTED (Oct. 9, 2003) [hereinafter CSA].

56. *Id.*

57. CSA, *supra* note 55, at Options A, B.

either party at any time.<sup>58</sup> Also, since it is unlikely that the price of natural gas will fluctuate substantially during the shorter term of trading contracts, the posting of an amount of collateral based on the calculation of the current Net Settlement Amount will not entail extreme swings in the amount of collateral required to be posted at any given time.

However, in the case of longer term arrangements, the use of a collateral posting mechanism linked to the calculation of the then payable Net Settlement Amount does run the risk of requiring a party to post potentially prohibitive amounts of collateral to match a significant swing in natural gas prices over time. Under extreme circumstances, such a requirement could lead to a liquidity crisis for the party required to post, specifically if Option A (requiring the posting of such collateral on the next business day) is selected.<sup>59</sup> Conversely, it is also possible that a party may be required to release large amounts of collateral leaving it feeling somewhat under protected.

Thus, in the event that parties are using a NAESB Contract for purposes of effecting one single long-term arrangement, the parties may want to craft their own more simplified credit support requirements. Notwithstanding the foregoing, should the parties effecting a long-term arrangement opt to use the CSA, they should probably: (i) elect to use a rating matrix (if the parties are rated), which would not require the constant exposure monitoring that would otherwise be applicable and would avoid the risks associated with large fluctuations in the price of natural gas resulting in excessive swings in the collateral posting requirement, (ii) if it is not possible to use a rating matrix, consider including some type of minimum and maximum band for the total amount of collateral to be posted to avoid extreme fluctuations in the collateral posting requirements, which could be triggered by substantial changes in the price of natural gas over time, and (iii) select Option B and determine their own desired time frame for the posting, substitution and/or release of collateral to allow the party required to post collateral a little more time to satisfy its obligations and avoid pre-maturely tripping an Event of Default.<sup>60</sup>

Regardless of whether the parties elect to rely on the CSA or insert their own menu of credit support provisions in a Special Provisions Addendum, in order for each party to monitor the credit quality of its counterparty and its counterparty's credit support provider over time, a provision should be included in a Special Provisions Addendum that requires the parties to deliver to one another un-audited-quarterly and audited-annual financial statements of the party and its guarantor, if any.

#### *D. Dispute Resolution*

Although section 14.5 of the Base Contract does permit the parties to choose the governing law for the NAESB Contract, the NAESB Contract does not include any type of dispute resolution clause. While the lack of a dispute resolution clause in a short-term spot agreement may, under certain circumstances where the value of the contract is not significant, be acceptable

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58. *Id.*

59. CSA, *supra* note 55, at Option A.

60. *Id.*

because, given the relatively short timeframe for performance, the likelihood of a dispute arising is limited (and, particularly if the value of the contract is not substantial, its consequences are likely also limited). However, in the context of a long-term contract, it could be catastrophic to leave out a dispute resolution mechanism, as it is far more likely that a dispute between the parties will arise given the more extended timeframe involved and, in the event that a dispute did arise, the consequences would be much more costly.<sup>61</sup>

Thus, for certainty of enforcement with respect to any such dispute, the parties should include in a Special Provisions Addendum either (i) a jurisdiction and venue clause whereby the parties each consent to the jurisdiction of the courts of a particular state and the federal courts sitting in such state or (ii) an arbitration clause. While both a jurisdiction clause and an arbitration clause will ultimately lead to the same result (a final decision resolving the controversy at hand), the procedures involved are very different. A jurisdiction clause will entail a judicial procedure before a court in the relevant jurisdiction, along with all of the formal trappings that accompany such proceedings (*e.g.* discovery periods and rules of evidence). An arbitration clause, however, is a creature of contract law and, as such, may be tailored by the parties in a manner to best suit the transaction at hand. In such regard, it is critical that an arbitration clause contain at least the following elements: (i) the types of disputes to be governed by such clause (*i.e.* any dispute or certain specific disputes), (ii) the relevant rules of arbitration to be followed and/or whether the procedure will be supervised by a recognized arbitral body, (iii) the number and relevant qualifications of the arbitrators to be selected, and (iv) the intended location of any such arbitration.<sup>62</sup> In addition to these elements, it will also be important for the parties to consider: (i) whether it is desirable to have a non-binding mediation procedure prior to the commencement of an arbitration proceeding, (ii) the allocation of costs among the parties with respect to any such procedure, (iii) the extent and scope of discovery (if any), (iv) the applicable rules of evidence (if any), and (v) the language in which the procedure should be governed, for international disputes.<sup>63</sup>

In fact, the Energy ADR Forum has recently issued a report on the use of alternative dispute resolution (ADR) to resolve energy industry disputes (Report).<sup>64</sup> Specifically, the Report suggests that transactions implemented under the NAESB Contract, among other standard form agreements used in the energy sector, would benefit from ADR. The Report further recognizes that (i) dispute resolution frameworks for long term arrangements do require special attention and advice of experienced counsel and (ii) non-binding mediation provisions, involving the elevation of disputes to higher management and the

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61. 7 WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 15:11 (4th ed. 2002) [hereinafter 7 WILLISTON]; *see also* D. Ryan Nayar, *Analyzing the Use of Compulsory Mediation Clauses in Commercial Contracts: Advantages, Enforceability, and Drafting Guidelines*, 40 TEX. J. BUS. L. 257 (2004).

62. W. LAURENCE CRAIG ET AL., INTERNATIONAL CHAMBER OF COMMERCE ARBITRATION 85-125 (3d ed. 2000).

63. *Id.*

64. The Energy ADR Forum: Using ADR to Resolve Energy Industry Disputes: The Better Way (October 2006) (on file with the Energy Law Journal).

appointment of technical experts, if necessary, are useful in facilitating the timely resolution of disputes in the energy sector.<sup>65</sup>

Without the inclusion of either a jurisdiction clause or an arbitration clause, including some or all of the suggested provisions described above, the parties to a long-term NAESB Contract will face uncertainty as to where and how a dispute will be settled and may incur additional time and expense to resolve any dispute between the parties as to where the dispute should be resolved.<sup>66</sup> Such a protracted route to dispute resolution will increase both the transaction costs to the parties and the acrimony between the parties; ultimately, possibly chilling the development of more transactions among sector participants.

Further, in the event that there are other contracts involved in the overall transaction, it would probably also make sense, especially from the buyer's perspective, for the parties to select a dispute resolution clause and choice of law provision consistent with those set forth in the other primary transaction documents, such that if multiple disputes do arise they could be consolidated into one proceeding if such consolidation were appropriate. A failure to make any selection as to dispute resolution or a failure to select a consistent choice of law or forum for dispute resolution would make it virtually impossible for the parties to consolidate proceedings where this may be desirable. As a result, the parties could incur significant additional expense in re-litigating the same point with different contractual counterparties, under different laws, and in different jurisdictions.<sup>67</sup> This result could be disastrous for the party caught in the middle, likely the buyer, or its financiers.

#### *E. Completion Risk*

The NAESB Contract by its terms contemplates a contractual relationship between two parties that are ready and able to buy or sell natural gas, as the case may be. It has not been designed to address issues involving the construction of a power generating facility or other industrial facility that will rely on natural gas deliveries to operate after it has been fully constructed. As a result, each of the parties must be cognizant of two related issues. First, the buyer will not want a Confirmation to become effective until the construction of the facility is complete and it desires or is obligated to start generating electricity or otherwise operating the relevant facilities. The seller, on the other hand, will not want to have a long-term commitment to sell natural gas subject to an open-ended condition. As a result, these two interests will typically result in the Special Provisions Addendum making the effectiveness of a Confirmation subject to the satisfaction of a condition that the relevant power generating or industrial facilities are completed and in service, and ready for receipt of natural gas by a date certain. If such condition is not satisfied in a timely manner (*i.e.*, on or prior to the specified date certain), the Confirmation will cease to be effective and terminate, either without liability against either of the parties or, depending

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65. *Id.*

66. 7 WILLISTON, *supra* note 61, § 15:11; D. Ryan Nayar, *Analyzing the use of Compulsory Mediation Clauses in Commercial Contracts: Advantages, Enforceability and Drafting Guidelines*, 40 TEX. J. BUS. L. 257 (2004).

67. WILLIAM W. PARK, INTERNATIONAL FORUM SELECTION (1995).

on the strength of seller's bargaining position, possibly with an early termination fee payable by buyer.

#### *F. Replacement Index*

Since (i) the price for natural gas to be delivered pursuant to a Confirmation will frequently be linked to some extent to a natural gas pricing index and (ii) section 3.2 of the Base Contract relating to the calculation of damages for a failure to deliver or accept natural gas makes reference to a pricing index to make such calculation, it will be important in any long-term natural gas arrangement using the NAESB Contract that the parties incorporate into the Special Provisions Addendum a provision establishing a mechanism for the adoption of a substitute index that will form the basis of such calculations in the event the primary index is unavailable.<sup>68</sup>

In the short-term context, the likelihood of the specified index becoming unavailable or being superseded by some other index is relatively unlikely. In this context, then, the inclusion of an alternate mechanism would not be critical. However, in the context of long-term arrangements, it is far more likely for events to occur that could result in the specified index being temporarily or permanently unavailable during a time period when it is needed for purposes of implementing a key contractual provision, such as, the pricing of natural gas purchased or the establishment of the measure for determining damages payable by a party. In such circumstances, the unavailability of the specified index could create great uncertainty and some serious problems with respect to the enforcement of the contract.<sup>69</sup>

A typical "replacement index" provision would give the parties a certain period of time, say three to five business days, to agree on a substitute index or mechanism for establishing the price of natural gas. In the event the parties are unable to reach agreement in this regard during such specified time frame, the provision would further stipulate that an average of the prices quoted by certain analogous indices, traders, or brokers for deliveries of natural gas in the same general geographic location would govern.

#### *G. Representations and Warranties*

The NAESB Contract contains little in terms of representations and warranties by the parties. Basically, the seller provides a representation as to title to the natural gas that it is selling to the buyer, and both parties provide a basic representation as to their authority to enter into the agreement.<sup>70</sup>

The parties may want to include more comprehensive representations and warranties as to each party's ability to enter into the contract, as well as to the contract's enforceability against each party. They may also want from each other representations that there are no conflicts or required consents that could compromise a party's ability to perform. While these inclusions are not absolutely necessary for purposes of effecting a long-term natural gas

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68. JAMES J. WHITE & ROBERT S. SUMMERS, WHITE AND SUMMERS' UNIFORM COMMERCIAL CODE §§ 6-8 (4th ed. 1995).

69. *Id.*

70. NAESB CONTRACT, *supra* note 1, §§ 8, 14.8.

arrangement, they would provide some additional comfort that each of the parties will be in a position to perform the agreement during the course of the transaction. In a long-term transaction where credit exposures can be significant and where certainty of supply or sale of natural gas at a particular price is important, the additional comfort provided by these provisions could be substantial. In addition, when taken in conjunction with the suggested amendments above to section 10.2 of the General Terms relating to Events of Default, if one of these additional representations and warranties were later found to have been breached in a material manner and the non-breaching party felt that the breach would compromise its position going forward, it would have the option, subject to the relevant cure period, to terminate the contract, collect any damages that would be payable by the breaching party, and enter into more secure arrangements with a different counterparty.

#### IV. CONCLUSION

Although, according to NAESB, the NAESB Contract has been designed to be utilized in both long-term and short-term natural gas transactions, its genesis as a short-term trading contract remains evident in the large number of the provisions it contains that have a short-term orientation. Its short-term focus is also apparent in the notable absence of a number of provisions one would expect to see in a more long-term arrangement. Thus, it would be fair to say that as drafted and without any modification the NAESB Contract is more appropriate for short-term arrangements. It is nevertheless true that the NAESB Contract has been crafted with options and flexibility such that the parties may transform it into an agreement suitable for the long-term. To the extent that the parties make the appropriate selections, amendments and additions to the NAESB Contract when seeking to use it in a long-term context, the NAESB Contract should prove suitable for such purpose and should adequately protect the respective interests of the parties, and any financiers involved in the transaction.