ENERGY BAR ASSOCIATION®

Current Issues in Natural Gas Generation

Thursday, September 27, 2012
11:30 am – 1:00 p.m. CT
Location: Cadwalader, 1111 Bagby Street, Ste 4700; Houston, TX 77002

The Energy Bar Association's Natural Gas Regulation Committee and Houston Chapter present Current Issues in Natural Gas Generation, a brown bag in Houston, Texas. Panelists will discuss (1) Asset Management Agreements, (2) Fuel Supply Agreements and (3) Pipeline Construction Agreements. Panelists include Ken Irvin of Cadwalader, Eric Dennison of EDF Trading, Alyssa Schindler of NiSource. Blake Jones of Panda Power Funds will serve as the event Moderator.

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FERC Requirements for Asset Management Agreements

Kenneth W. Irvin

September 27, 2012

Asset Management Agreements

- **What is an AMA:**
  - **An AMA is a transactional vehicle through which one party can release interstate pipeline or storage capacity to another party without the release being subject to:**
    - **The Commission's capacity release bidding requirements or the Commission's restrictions on "tying," or conditioning a capacity release on the replacement shipper's agreeing to "extraneous conditions" (e.g., agreeing to purchase goods or services unrelated to the released capacity).**
    - **To distinguish it from a typical standard capactiy release, the AMA must be a bona fide transaction (i.e., a real obligation to deliver/purchase gas) to satisfy the releasing party's legitimate needs**

The “Five in Twelve” Condition

- **Releasing shipper must have the right under AMA to call upon the asset manager to deliver to, or purchase from, the releasing shipper a volume of gas up to 100 percent of the daily contract demand of released capacity on any day during one of the following minimum periods:**
  - **If the AMA is for a period of more than one year, the minimum period is five months (or 155 days) of each 12-month period of the release. If the release is for a period of more than one year but includes an additional period of less than twelve months, the asset manager’s purchase/delivery obligation must apply during five-twelfths of the days during the additional period.**
  - **If the AMA is for a period of one year or less, the minimum period is the longer of five months (or 155 days) or the length of the release.**
- **This is a temporal rule. It does not require the asset manager also to deliver, or purchase, a certain aggregate volume of gas over the relevant minimum period.**
- **The required time periods do not have to run consecutively.**

Posting Requirements

- **The relevant pipeline must post a notice of the capacity release occurring under an AMA on the pipeline's public electronic bulletin board. The notice must be provided not later than the first nomination submitted with respect to the released capacity. The capacity release under an AMA is not subject to further Commission approval.**

Posting Requirements
Continued

- **Such notice must describe or provide:**
  - **The asset manager's obligation or deliver gas to, or purchase gas from, the releasing shipper (to confirm that it meets the "five in twelve" condition described above).**
  - **The name of the releasing shipper and replacement shipper (i.e., the asset manager).**
  - **The identification numbers of the contracts subject to the release.**
  - **The rate charged by the pipeline and by the releasing shipper for the released capacity.**
  - **The maximum pipeline tariff rate subject to the released capacity.**
  - **The duration of the release.**
  - **The receipt and delivery points and pipeline zones and segments covered by the released capacity.**
  - **The quantity of the release.**
  - **Special terms and conditions applicable to the capacity release transaction.**
  - **Whether there is an affiliate relationship between the pipeline and the shipper or between the releasing and replacement shipper.**

Other Important Aspects of AMAs

- **In addition to these general requirements, please note the following:**
  - **Payments or other consideration exchanged between the releasing shipper and the replacement shipper as part of an AMA capacity release "are not subject to the maximum rate" limitation generally applicable to capacity releases.**
  - **However, for any AMA longer than one year, the stated consideration for the released capacity may not exceed the max rate.**
  - **A releasing shipper is free to release all or a portion of its pipeline or storage capacity in an AMA.**

Other Important Aspects of AMAs
Continued

- **An asset manager may, but is not required to use the specific released capacity to fulfill its delivery/purchase obligations under an AMA.**
- **There is no restriction on which types of entities may enter into an AMA.**
- **The delivery/purchase obligation under an AMA does not need to be a single continuous period. Parties are free to set the delivery/purchase obligation over months or days as they please, treating every 31 days as a month.**

Other Important Aspects of AMAs
Continued

- **An asset manager's delivery/purchase obligations under an AMA are subject to a pipeline or storage facility's operational limitations set forth in its tariff.**
  - **An example is a "ratchet" provision limiting the rate of injections and withdrawals from storage facilities, which may prevent a party from injecting/withdrawing the full contract demand on a given day.**
- **For AMAs that include releases of both storage and transportation capacity, the delivery/purchase obligations are not cumulative unless the storage has its own separate transportation.**
- **Capacity releases done under an AMA are not subject to the anti-rollover rule, which generally prevents parties from immediately extending short-term releases (31 days or less) that are exempt from competitive bidding.**

Other Important Aspects of AMAs
Continued

- **AMAs can impose upon a releasing shipper an obligation to demand the asset manager's delivery or purchase of gas by no earlier than 8:00 am on the weekday before gas flow through the released capacity.**
- **The releasing shipper in an AMA may include more capacity in an AMA than it typically uses to meet its historical gas demands, provided that there is a bona fide purchase/sale obligation.**
  - **Nonetheless, all capacity released in an AMA is subject to the delivery/purchase condition, even when it exceeds the releasing shipper's typical demand.**
- **An asset manager may release the capacity to another shipper in a separate AMA.**

Other Important Aspects of AMAs
Continued

- **AMA's are not subject to the Commission's prohibition on "buy/sell" arrangements. Thus, under an AMA, a releasing shipper can retain the obligation to purchase gas in the supply area, sell that volume to its asset manager, and then repurchase it from the asset manager in the downstream market.**
  - **NOTE: this is more limited-gas must be delivered at the city-gate and cannot be resold to others**
- **LNG importers holding firm capacity on interstate pipelines connected to an LNG terminal are free to use a supply AMA. If the LNG receiving terminal is regulated under the Commission's open-access regulations, a release of terminal capacity could be tied to a release of downstream transportation capacity without using the AMA structure. However, such a release would be subject to the Commission's posting and bidding requirements and other general capacity release rules.**

Additional points

- Gulf Crossing Pipeline Company case (permanent release for AMA)
  - FERC clarified a letter order accepting a permanent capacity release agreement containing a negotiated rate, stating "that a permanent release may qualify as a 'release to an asset manager'" as defined in section 284.8(h) of the FERC's regulations issued in Order 712 series.
  - FERC clarified that either temporary or permanent releases can qualify as asset management agreements, which are exempted from the FERC's capacity release rules on posting and bidding and its prohibition on tying
- Limited buy/sell only expressly for demand side AMAs
- 712B scenario-each leg of transport must independently qualify as an AMA
- Retail provisions

Natural Gas Generation Issues

Energy Bar Association
September 27, 2012

Considering the Base Contract

NAESB	Has the obvious luxury of being standardized. May require significant customization in the form of special provisions and sophisticated transaction confirmations. Contains unwieldy credit support terms; and no margining. Can include a margin annex to provide margining.
ISDA with Gas Annex	Similar attributes of standardization although a more limited audience. May require significant customization of special provisions and transaction confirmation for customized commercial terms. Provides convenient credit support protocols; including margin provisions.
Customized Gas Supply Agreement	Non-Standard although many adopt conventional terms and conditions from the NAESB. Allows for customization that is responsive to unique terms and conditions. Will require importation of structured credit support terms beyond mere adequate assurance of performance. Requires importation of terms that are the hallmarks of “forward contract treatment”, “Mobile Sierra”, and unique demands of agreements with governmental and quasi governmental entities.

Counterparty Considerations

1. Is the counterparty a typical sophisticated purchaser of natural gas?
2. Is the counterparty a governmental or quasi-governmental entity?
3. Is the project to which the gas is to be provided subject to project financing or other structured financing obligations?
4. Is the counterparty an eligible contract participant?
5. Is the counterparty interested in executing financial hedges in addition to physical supply?
6. Are their unique “know your customer issues” that are implicated?
7. Does the transaction involve an “energy management agreement” of which the supply component is a part, or is the supply component part of a regulated asset management arrangement (e.g., order 712)?
8. Does the counterparty insist on utilizing their form of gas supply agreement (particularly true if there is project financing)?

What's the Product?

Physical Supply

- Is the transaction fundamentally a physical supply arrangement?
- Product Definition – Is the transaction "firm", "non-firm", "transportation contingent", or a hybrid.
- Force Majeure – See subsequent slides but are there unique Force Majeure attributes. What is "not" force majeure may be more important than what is force majeure.
- Delivery Point – Where is the delivery point? "Burner tip", "city-gate" etc.
- Balancing – Does the delivery point allow for unique balancing arbitrage opportunities through customer storage on the "pipe" or behind the city gate?
- Is the supply "base load" or some alternative?

Services Accompanying Supply Etc.

- Does the counterparty require accompanying services?
- Scheduling – How will gas be scheduled to the facility?
- Transportation – Any release of transportation or other AMA issues? Does the customer have "take away" transport?
- Storage – Are there related storage issues?
- Alternative Fuels – Does the supply obligation contemplate alternative fuels; e.g., diesel, crude oil etc.
- Balancing Services – How is balancing handled? Is there a re-sale of gas? Sharing of profits/losses?

Financial Hedging

- What are the hedging aspirations of the counterparty?
  - Fixed for Floating Swaps
  - Options
  - Puts and Calls etc.
- May affect the approach with respect to the form of agreement
- Significant Credit Implications

Force Majeure

1. **Standard Definition** - When supplying gas to a power plant or other industrial facility, the definition of firm and non-firm is inevitably tied to force majeure.
2. **Threshold Issue** – How extensive will the force majeure definition be treated? Is the definition confined to "events beyond the control of the claiming party" with the usual NAESB suspects (e.g., the so-called acts of God).
3. **Exceptions** - Are there specific exclusions from force majeure and if so, what are they? For example, freeze-offs, freezing of wells or lines of pipe, interruption of transportation, interruption of firm transportation, breakage of machinery or lines of pipe.
4. **Fixed Price Pitfalls** – How is Force Majeure handled in the context of fixed price. Does fixed price convert the contract to "take or pay" for example? If not, how is the fixed price risk handled? See extreme examples from Hurricane Katrina and Hurricane Ike.
5. **Buyer Force Majeure** – Should the agreement specify exclusions from force majeure particularly in a fixed price context? For example, should the seller exclude negligence, breakage of machinery, improper maintenance of the facility, failure to follow planned maintenance guidelines for the facility, failure to follow manufacturer's guidelines, improper O&M procedures, or exclusions where the cause cannot be readily determined?
6. **Notice Requirements** – Another pitfall for the unwary. Should the NAESB protocol be observed (e.g., oral notice as soon as possible, followed by written notice)? Consider specific reasons for a departure from this protocol e.g., monthly or daily balancing requirements, re-sale obligations, or unique allocation of balancing and imbalance penalty risks in general.

Pricing Considerations

1. **Fundamental** – Is the agreement to be a fixed price or index priced product? In either case are there adjustments for basis differentials or other adjustments to the established price?
2. **Index Prices** – Quote the index properly! Take the time to quote the index step by step from the applicable publication. Establish a date whereby monthly index pricing must be established (e.g., before NYMEX "close") and a deadline by which any daily index price for daily volumes must be established. Note fallback pricing for failure to quote.
3. **Fixed Price** – If the agreement is fixed price, identify any adjustments or increases in the price over time. For example, is the price subject to renegotiation or adjustment for changes in law, changes in taxes, built in adjustments for longer term transactions such as increases tied to a price escalator.
4. **Add-Ons** – Are there add-ons to the price for services; e.g., asset management services, scheduling and nomination or typical energy management agreement services?
5. **Settlement** – Are settlement terms standard (25th day after month of flow)? Note differences for government contracts with longer settlement protocols.

Default and Remedies

1. **Basic Concerns** – Are the events of default essentially bilateral? Are they confined to the standard NAESB events of default? Most index transactions fall within the scope of the standard events of default definitions.
2. **Customized EOD** – Does the transaction require consideration of customized events of default? Are there unique credit attributes or downgrade events that require specific treatment? Any unique affirmative or negative covenants where the standard 30 day non-monetary default should be shortened?
3. **Credit Events of Default** – Are downgrade events treated as a default? If outside the ISDA, these should be treated like an early termination event.
4. **Cross-Defaults** – Consider carefully the nature of cross-defaults. Are there typical ISDA-like cross defaults to third party indebtedness, and if so how is the threshold determined? Project financing cross defaults may be appropriate.
5. **Unintended Defaults** – Be wary of including items that are really termination events as events of default; e.g., change in law. This can have unintended effects in the context of remedies where there is no real party at fault..

Remedies

1. **Fundamental** – Are the remedies bilateral? Are the remedies typical of standard close-out and termination treatment?
2. **So-Called One Way Termination** – The counterparty may insist on one-way termination (e.g., non-defaulting party never pays the net settlement amount) particularly in the context of governmental entities. Irrespective of your point of view (e.g., that you will never default), one-way termination is often a challenge.
3. **Forward Contract Concerns** – The remedies should be consistent with forward contract treatment under the bankruptcy code. One-way termination may erode forward contract treatment (e.g., our recent experiences with Patriot Coal).
4. **Calculation of Net Settlement Amount** – Ensure that calculation of net settlement amount includes all transactions, fees and other amounts payable particularly if there are accompanying asset management arrangements.
5. **Master Netting Agreement** – Remedies that are inclusive of all transaction components ensure that the contract will be treated in a manner that is consistent with master netting agreements.

Remedies (continued)

6. **Triangular Setoff and Cross-Affiliate Netting** – We typically avoid the insertion of cross-affiliate netting irrespective of our views about enforceability in bankruptcy and beyond. Although there is a prevailing view that such provisions are unenforceable, there are still a lot of subscribers particularly among governmental entities. Many issues in the aftermath of Lehman were the result of inadvertent use of cross-affiliate netting. Avoid the seduction of point of view (e.g., that cross-affiliate netting is always a sword).
7. **Uniform Commercial Code** – Inclusion of references to the UCC is often helpful where the counterparty is advocating generic remedies such as “all remedies at law or in equity” in lieu of close-out and termination. Expresses intent of the parties to apply traditional Article 2 remedies.
8. **Forward Contracts Again** – Limitations of remedies and articulation of unusual remedies can lead to frustration of forward contract treatment. The first thing that a bankruptcy counterparty will argue is violation of the “stay in bankruptcy” and absence of forward contract treatment if the remedies are unilateral, incomplete or do not otherwise line up with forward contracts.

Project Finance Credit

1. **Initial Inquiries** – Many projects have limited ability to provide credit assurances, much less to provide margin or similar transfers of cash or letters of credit.
2. **Limited Credit Facility** – Although limited, some project financed facilities can provide letters of credit typically to establish an "independent amount". These are accompanying features of the project financing, but are typically insufficient to allow the project to respond to margin calls.
3. **Liens and Inter-Creditor Arrangements** – We will on occasion consider an outright pledge of the facility or an inter-creditor arrangement with the existing project creditors where the lien provides security for the hedging and physical supply.
4. **Limitations on Inter-Creditor Arrangements** – While participation in project financing arrangements provide legitimate security it has limitations. Liens are typically "pari passu" with other lenders but have significant "stand still" accommodations or other impediments to foreclosure absent a complete failure of the project.
5. **Will the Lenders Look Out For Me** – Even absent liens that participate in the project debt, the project lenders may provide some practical comfort. The gas supply is key to the project financing package and therefore the project financing itself is at risk if the gas supply arrangement is terminated.

Consents to Collateral Assignment

1. **Fundamental** – As noted, the gas supply component is key and the lender does not want the gas supplier to have the ability to precipitously terminate the agreement.
2. **Consents to Collateral Assignment** – As the gas supply agreement is part of the project assets, the project lenders will ask the project to collaterally assign the gas agreement and for the supplier to consent to that assignment.
3. **Forms of Collateral Assignment** – Many lenders insist on a form of collateral assignment that they prefer. The form of consent is often included as an exhibit to the gas supply agreement although occasionally negotiated thereafter. If not included, the supplier should covenant to provide the consent only if it does not materially "impair the rights and remedies of the supplier, substantially increase the obligations of the supplier, or substantially increase the risk profile of the supplier in its reasonable judgment".
4. **Key Features** – At a minimum, the consent will: recognize the financing, agree that lenders can step into the shoes of the project upon foreclosure, recognize the lender as the new owner and gas purchaser, require the supplier to provide notices etc. to the lender…..and…...
5. **Accommodations of Remedies** – The single biggest issue with consents to collateral assignment is the invariable request to extend the cure periods for events of default, and to delay the enforcement of remedies to give the project lenders the opportunity to "fix the problem".

Consents to Collateral Assignment (cont.)

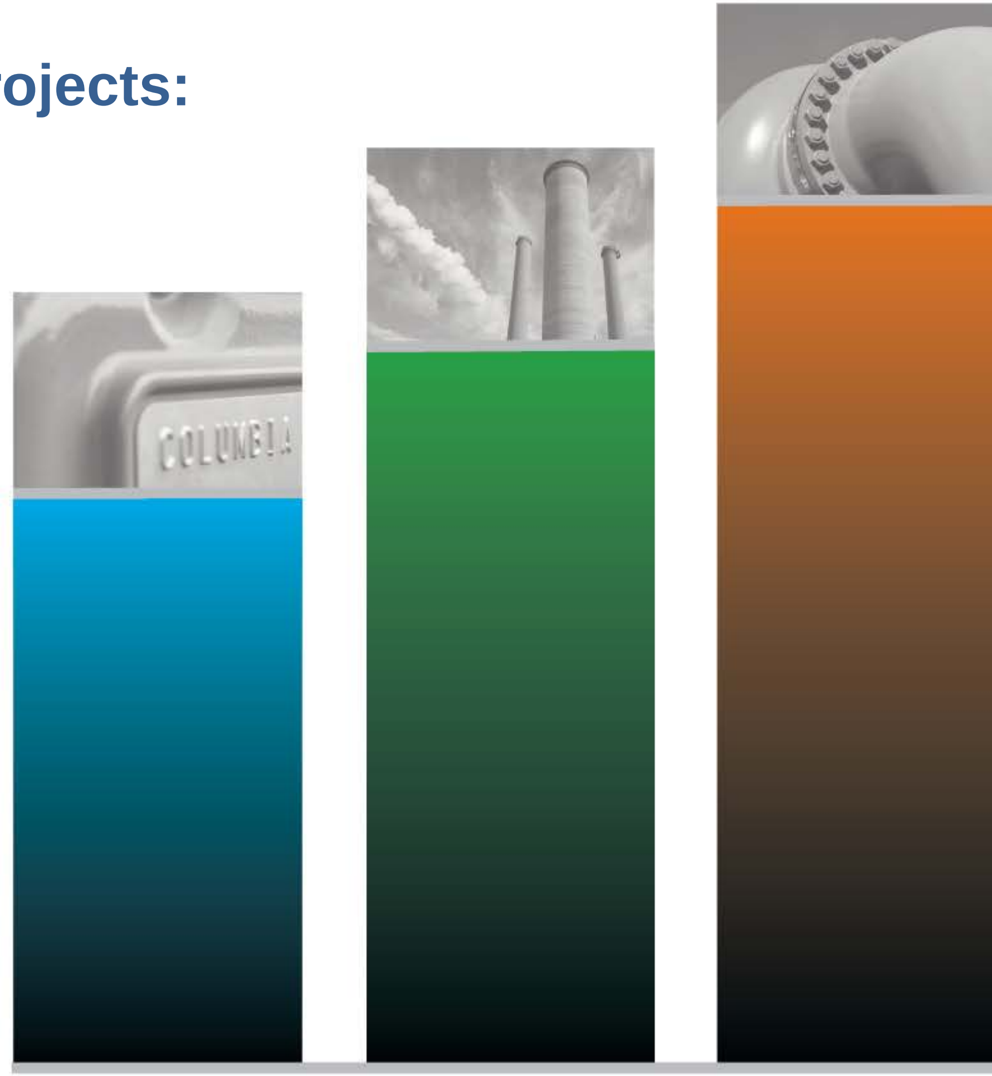
6. **Typical Requests** – Typically the lenders ask for additional cure periods that range from 60 days or more for "monetary defaults" to 90 to 120 days for "non-monetary defaults".
7. **The Accommodation Period –** We typically refer to the increased time offered to the lenders to cure project defaults as the "accommodation period".
8. **Key Pitfall** – The single biggest risk associated with providing extended accommodation periods is the increase in potential exposure during the accommodation period. In other words, while awaiting the lenders' response, the exposure at the beginning of the accommodation period, when the supplier could have terminated absent the accommodation period, could increase materially by the end of the accommodation period. Many project lawyers either do not understand the issue (or perhaps don't care).
9. **Potential Solutions** – Obviously this can be managed to some degree by shortening the accommodation period as much as possible so that it runs concurrently with the standard cure periods in the agreement. There are differing views on what is market but 10 days for monetary defaults and 30 days for non-monetary defaults appear to be common currency.
10. **One Alternative** – If the project lenders insist on an extended accommodation period, one approach is to ask the lenders to collateralize the increase in exposure during the accommodation period by providing conventional margining etc. We have been successful in at least two occasions where the lenders were insistent on long dated cure periods for monetary defaults.

Miscellaneous Provisions

1. **Usual Suspects** – Consider the usual suspects of governing law (Texas, NY), jurisdiction, venue etc..
2. **Arbitration** – We typically include arbitration with "baseball style" limitations.
3. **Mobile Sierra** – Include standard and up to date Mobile Sierra language. Many outdated versions in current circulation.
4. **Reps and Warranties** – Include the typical representations and warranties. Note additional representations for governmental entities. We employ a modified Schedule M adapted from the version provided by EEI for gas transactions with governmental entities where "political risk" is more acute.
5. **RUS Entities** – Is the entity an "RUS" borrower? If so, is RUS approval required? Ensure that reps and warranties are sufficient to make the counterparty consider this point if there is any concern. Applies to electric cooperatives.
6. **Evidence of Authority** – Go to the trouble of obtaining incumbency and related certificates especially for term transactions with fixed price.

B U I L D I N G

Natural Gas Generation Projects: Pipeline Agreements



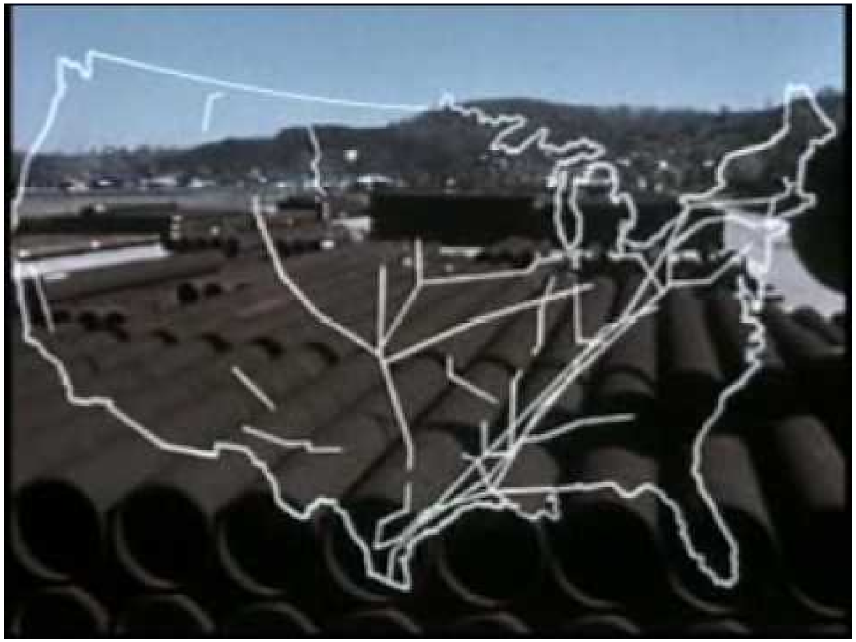
Alyssa Schindler, Senior Counsel
September 27, 2012

NiSource®

Outline

- Who to Connect To?
- Getting Started
- Precedent Agreements
- Credit Support Agreements
- Interconnect Agreements

Who to Connect To? Interstate, Intrastate or LDC



Factors to Consider

- Location
- Supply sources and liquidity
- Service needs and requirements
- Level of regulation

Starting the Process

- Specific Requests for Service
  - Requests for Proposals
  - Reimbursement Agreements
- Open Seasons
  - Anchor Shippers
  - Allocation

Project Precedent Agreements

- **What You're Getting: Rates and Terms of Service**
  - Recourse, Incremental and Negotiated rates
  - Type and Character of Service
  - Other Service Terms
- **How to Get Out: Conditions Precedent**
  - Regulatory Approvals
  - Economic Conditions
  - Other Outs
- **Protecting Yourself: Liability and Damages**

"The paper and ink content is within acceptable norms, but the contract itself appears to have too many clauses."

Credit Support Agreements

- Initial Creditworthiness Determination
- Amount and Term of Credit Assurance Obligations
- Posting Credit Assurance
- Return of Posted Credit

Interconnection Agreements

- Cost Responsibility
- Design and Construction
- Land Rights and Permits
- Operations and Maintenance
- Future Facilities Costs

QUESTIONS?