January 14, 2002

To: Rae McQuade, North American Energy Standards Board
From: Carl Peterson
Subject: Comments to the Draft Base Agreement as of 11/7/01

We believe that this draft is a significant improvement over the present Short Term Base Agreement and wish to thank the sub-committee that worked on it for its efforts. We prefer a single agreement that captures both long-term as well as short-term transactions.

Our comments to the draft Base Contract are below:

1) We disagree that Texas law should appear as the default choice of law. There should either be no default choice of law or it should be New York for the reasons mentioned in both Sempra Energy Trading Corp. ("Sempra") and J.Aron & Company's (J.Aron) comments.

2) If Oral Transaction Procedure is chosen as the option for Section1.2, then we believe that a binding Transaction Confirmation (binding means that a party has not responded to a previously sent Transaction Confirmation within two Business Days) should have precedence over a recorded conversation except in cases of manifest error in the Transaction Confirmation. If the parties bargain for "X" and this is duly noted in the recorded conversation, but the Transaction Confirmation states "Y", then because of the manifest error in the Transaction Confirmation, the recorded conversation should be given the highest priority in Section1.3. Accordingly, we believe that Section 1.3 should read "In the event of a conflict among the terms of (i) a binding Transaction Confirmation, pursuant to Section 1.2, (ii) … and (v) these General Terms and Conditions, the terms of the documents shall govern in the priority listed in this sentence absent manifest error in document (i), in which case document (ii) will have priority over document (i)."

3) We concur with Sempra's comment that the close-out and liquidation of forward contracts would be strengthened if all Transactions entered into pursuant to an executed Base Agreement were deemed to be one integrated contract.

4) Delete the words "or alternative fuels" in the second line of Section 2.9 and the third line of Section 3.2. Unless there is a force majeure situation, the buyer or the seller should be able to buy/sell Gas. The concept of a party being obligated for a commodity they had not bargained to either buy or sell is troublesome.

5) In Section 3.2, there should be a date by which payment should be made for failure to deliver or receive Gas. It should occur promptly after the value of the performance breach been quantified. We suggest the following: "The amount of such unfavorable difference shall be payable within two Business Days after

presentation of the non-breaching party's invoice for such amount which shall set forth the basis which such amount was calculated."

6) We suggest that schedulers have the opportunity to "bookout" various purchases and sales entered into at the same delivery point in the same delivery month with the same counterpart, subject to rules of the Transporter. We propose adding a new Section 4.4 at the end of Section 4: "4.4 If, at the time the parties enter into a Gas purchase and sale transaction under which one party is to sell Gas to the other, one or more other Gas purchase and sale transactions are outstanding under which such other party is to sell Gas to such first party for delivery during the same Delivery Period and at the same Delivery Point for payment on the same Payment Date, then (subject to a) any applicable regulations of the relevant Transporter and b) Section 10) all such offsetting transactions shall be netted into a single transaction under which (a) the party required to deliver the larger amount of Gas shall deliver to the other party the difference between the amount of Gas it is to deliver and the amount it is to receive under such offsetting transactions, and (b) the party owing the greater purchase price under such offsetting Gas purchase and sale transaction shall pay to the other party the difference between the amount it owes and the amount owed to it under such offsetting transactions. The single resulting transaction shall be deemed entered into automatically and, once entered into, outstanding obligations under the offsetting transactions shall terminate. Such netting shall not affect that transaction's status as a "Forward Contract" for purposes of the U.S Bankruptcy Code based on the date it was originally entered into."

7) We concur with Sempra that in Section 7.6 the words "on the same Payment Date" should be inserted after the words "all undisputed amounts due and owing".

8) In Section 9.3, the last sentence, we suggest that the words "five Business Days after mailing" be replaced with the words "upon actual receipt". The recipient should not have to take the risk of delayed mail service. You get the mail when you get the mail. Further, if Notices are being sent by facsimile, then they should be deemed received not upon the sending party's receipt of its facsimile machine's confirmation of successful transmission, but on the date that transmission is received by a responsible employee of the recipient in legible form (it being agreed that the burden of proving receipt will be on the sender and will not be met by a transmission report generated by the sending party's facsimile machine). This comports with the ISDA Notices provision.

9) We again concur with Sempra that there should be no option for "Forward Contract Damages Do Not Apply" as it makes no sense.

10) We concur with BG&E that in the last line of Section 10.2 the words "without prior notice" should be removed. However in the first line of Section 10.3 the words "by notice to the Defaulting Party" should be replaced with "by notice to the Defaulting Party, except in the case of (i) to (iv) in Section 10.2 above, in

which case no notice is required". Finally, the phrase in the penultimate line of Section 10.2 "terminate and liquidate the Contract" should for clarification read "terminate and liquidate those outstanding Transactions entered into pursuant to the Contract"

11) GISB has tied everything in the default provisions (outside of bankruptcy) to failure to pay. Thus the way you get to a default for performance is via clause 3.2 (where a party fails to perform under a transaction, the transaction is closed out and there is a failure to pay damages). The problem with this is that you don't get to close out for a potential failure to perform. We suggest that Section 10.1 read as follows: "Notwithstanding Section 3.2, if either party ("X") has reasonable grounds for insecurity regarding the performance of any obligation under this Contract (whether or not then due) by the other party ("Y") (including, without limitation, the occurrence of a material change in the creditworthiness of Y), X may demand Adequate Assurance of Performance. We also suggest that the following exception be added to the end of Section 10.2 (viii): "except in the case of a failure to pay pursuant to Section 3.2, in which case no notice hereunder shall be required in addition to that required under such Section."

12) In Section 10.3, for purposes of clarification (so as to avoid any doubt about which Early Termination Date is being considered) we suggest that the last sentence read "With respect to each Excluded Transaction, its actual termination date shall be the "Early Termination Date" for purposes of Section 10.3.1."

13) In Section 10.3.1 sixth line of first paragraph – does "liquidate <u>and accelerate</u> each Terminated Transaction at its Market Value" make sense? We suggest "liquidate <u>and terminate</u>" is more appropriate.

14) We concur with J.Aron's point regarding options to extend as found in Section 10.3.

15) We concur with J.Aron's point in Section 10.3.2 regarding the need for language to allow for the set-off of margin against any Net Settlement Amount.

16) In Section 10.4 provision should be made for payment of default interest on the Net Settlement Amount if not timely paid, as well as payment of expenses and legal fees incurred by the party seeking to enforce payment of the Net Settlement Amount.

17) We believe that the Force Majeure language in Section 11.2 (i) is too broad and that the words "or necessity of repairs to machinery or equipment or lines of pipe" should be removed.

18) In Section 11.3 Force Majeure, delete "or" before "(iii)" and before "(v)", add the following language after the end of clause (v): ", as provided in Section 11.2" and then add the following: "(vi) a State's controlling or rationing production; (vii)

increases or decreases in natural gas supply due to allocation or reallocation of production by well operators, pipelines or other parties; or (viii) any failure of a supplier or purchaser to perform, for reasons other than set forth in Section 11.2."

19) We concur with J.Aron that Section 14.1 be reworked. We believe, however, that no party should be able to assign its rights without the prior written consent of the other party.

20) We suggest that the following new Section 14.11 be included:
"14.11 Each Party waives its respective right to any jury trial with respect to any litigation arising under or in connection with this Agreement or any transaction.

21) Finally, as Sempra points out, the sub-committee should consider the inclusion of a formal Credit Addendum to the Base Contract. At the very least, the agreement should provide for the mitigation of delivery credit risk with the following new clause:
"14.12: If Buyer at any time exceeds the delivery credit line then in effect as from time to time established by Seller, Seller may, not later than the second Business Day before the last day on which Gas deliveries for that delivery month or Delivery Period, as applicable, can be nominated on Seller's Transporter (the "Last Nomination Day"), require Buyer, to the extent of such excess, to make due on its Credit Support Obligations by (a) prepaying for that transaction, (b) by providing an irrevocable letter of credit in Seller's favor in a form and substance and having such terms and conditions as Seller shall reasonably specify, issued by a major bank which is and remains acceptable to Seller; such prepayment will be made to, or such letter of credit received by, Seller within two Business Days after Seller's request (but no later than the Business Day before the relevant Last Nomination Day), or (c) providing Seller with other collateral in an amount acceptable to Seller in its sole discretion. In the event a letter of credit is provided, all charges at Buyer's bank relating to any letter of credit are for Buyer's account."

Our comment to the draft Canadian Addendum is below:

1) Section 7.6 insert "on the same Payment Date" after the words "all undisputed amounts due and owing".