

**HOW AND WHEN TO USE
GAS INDUSTRY STANDARD BOARD'S (GISB)
CONTRACT FOR SHORT-TERM SALES OF NATURAL GAS**

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I. CONTRACTING REQUIREMENTS OF TODAY'S NATURAL GAS SPOT MARKET

A. The Gas Marketing Revolution

1. Changes in Federal Regulation and Market Forces

Until the mid-1980's, producers sold their natural gas production in the field under long term contracts with pipeline purchasers. Gas marketers were rare. This made the gas marketing business relatively simple and straightforward: negotiate one contract for each package of gas (usually a field or group of wells) every ten to twenty years, and sometimes an occasional surplus gas contract. Potential purchasers were limited to those with pipeline assets in the vicinity of the production.

Beginning in 1983 to 1984, an oversupply in the natural gas market and drastic changes in producer¹ and interstate pipeline² regulation combined to produce an active spot market. The repainted 1996 picture of gas marketing looks much different. Producers sell gas to marketers (who are often affiliates of producers or pipeline companies) or to local distribution companies or directly to end users. The gas sold by producers to marketers is resold to local distribution companies or end users. Over half of these sales have terms less than one year, and over a third have terms of one month or less. For each of these sales, someone (either the seller or the buyer or both) must arrange for transportation, pooling gas supply from several sources and balancing of over and under deliveries and receipts. Each of these commercial and operational arrangements requires separate contracts.

2. Short-Term Contract Marketing Practices

Gas contracts of one month or less are negotiated in a far different manner than contracts for longer terms. Most month-long transactions are negotiated by telephone during "bid week", which is the third or fourth week of the month, depending upon the part of the country. Day trades of gas are conducted by telephone each morning prior to 10:00 am. Most companies' stated policy is for these verbal agreements to be confirmed in writing within one to five days, although stated policies often vary considerably from observable practices. Many of the larger marketers record their telephone conversations as documentation of particular transactions.

¹. Sales of gas sales by producers and non-pipeline marketers from wells spudded after 1977 were substantially deregulated as to delivery obligations after 1978 and as to price on January 1, 1985 pursuant to Section 601(a) and 121 of the Natural Gas Policy Act of 1978 (15 U.S.C. §§ 3331 and 3431 (1982); all remaining controls were lifted by January 1, 1993, pursuant to the Natural Gas Wellhead Decontrol Act of 1989, 15 U.S.C. § 3431 (1995).

². Federal Energy Regulatory Commission Order No. 636 has required interstate pipelines to unbundle their various gas pipeline services by offering firm and interruptible transportation and storage services to third party shippers on an "open access" basis at rates reflective of the costs actually associated with rendering the service. Order No. 636, *Pipeline Service Obligations and Revisions to Regulations Governing Self Implementing Transportation Under Part 284 of the Commission's Regulations; and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, 57 Fed. Reg. 13,267, III F.E.R.C. Stats. & Regs. ¶30,939 (Apr. 16,1992).

The challenge of the gas marketing revolution to gas contracting practices is how to document the multifold increase in gas sales/purchase transactions in such a manner as to clarify the terms of the deal, assure enforceability, and meet the time requirements of the commercial business. The contracting practices must also be cost efficient, as the spot market is largely a commodity market with very slim margins and therefore unable economically to support the overhead associated with complex contractual arrangements.

B. Effect of Gas Market Revolution on Gas Sales/Purchase Contracts

1. How Gas Contracts Have Changed

As is often the case, gas contracting practices have lagged the changes in gas marketing practices. Spot gas contracts today are generally shorter than their 1985 counterparts: quality and measurement provisions are omitted in deference to the tariff provisions of the transporting pipeline; shorter terms eliminate the need for elaborate price escalation provisions; minimum quantity provisions are either absent or significantly simplified. Also, most marketing companies have developed contract forms in which the parties agree to standard terms and conditions for all of their sales and purchases and then document each spot transaction with a one-page transaction confirmation designating the quantity, price, delivery point and any other special provisions.

2. Contracting Practices Remain Inadequate to Serve the Spot Market

While all of these changes have been helpful, current gas marketing practices in general do not meet the time requirements imposed by the commercial environment of the spot market. First, each marketing company blithely charges its marketers to use its own model form. Therefore, in each new prospective commercial relationship, the party perceiving itself to have the lesser economic clout must review, consider and negotiate the base terms and conditions proposed by the other party. To exasperate this situation, most marketers revise their base terms and conditions periodically, requiring repeated review and negotiation of contracts between old trading partners. Finally, the vocabulary for spot gas contracts is not standard. Therefore, even where base terms and conditions are neatly in place between parties, the traders do not remember the specific vocabulary used in a specific agreement, so that the vocabulary used on the transaction confirmation (which was drafted for use with a different base contract) does not match the vocabulary used in the base contract, resulting in considerable ambiguity. (Eg., The base contract may define service levels as “Interruptible”, “Base”, and “Firm”, but a transaction confirmation identifies the service level as “Swing”.)

The alarming reality is that a substantial volume of gas moves in today’s spot market with documentation that is inadequate to meet the most basic commercial needs: a clear statement of the primary aspects of the deal and enforceability.

II. ORIGINS OF THE GISB STANDARD FORM CONTRACT

A. Initial Standardization Effort

In November 1994, Karyl M. Lawson, Assistant General Counsel of MidCon Gas Services Corporation, delivered a paper to the Federal Energy Bar Association³ describing current changes in the gas market and challenging the industry to develop a standard gas sales and purchase contract form for use in the spot market. Ms. Lawson also published an invitation

³. Karyl M. Lawson, *Developing Standardized Natural Gas Sales/Purchase Markets*, NATURAL GAS JOURNAL (Feb. 1995) at 20.

in the 1995 issue of *Foster's Report*⁴ for anyone interested in participating in the development of a standard form contract. Her first meeting was held in February 1995 with 21 participants representing 14 different companies. That group⁵ produced a draft contract which MidCon then requested the Gas Industry Standard Board ("GISB") to adopt as a GISB Standard for Electronic Business Transactions.⁶

B. Who is GISB

GISB was created in 1994 as a voluntary organization of approximately 200 companies representing all segments of the gas industry, including producers, marketers, pipelines, local distribution companies and end-users, to develop uniform standards to support electronic communication within the gas industry. Such standards are necessary to implement such practices as electronic communication of nomination and scheduling information, assignment or trading of excess transportation and trading of physical natural gas. Development of a standard spot gas sales and purchase contract is critical to the development of electronic trading of physical natural gas.

C. Drafting Process for GISB Standard Form

The MidCon sponsored draft contract was distributed to GISB members in July 1995 along with a survey form requesting the member companies' opinions regarding the need for a standard contract for use in electronic trading and the appropriateness of the MidCon form. The survey responses compiled in August 1995 showed general overwhelming support for GISB's development of a model gas sales contract but less support for some of the provisions contained in the MidCon form. Based on these results, the GISB Board of Directors commissioned a task force in late August 1995 to proceed with the development of a standard gas sales/purchase contract and at the same time to determine the data elements necessary to allow electronic transactions to be made. The "contract language" part of the task force was chaired by C. A. Y. (Tony) Shepard of Columbia Gas Distribution Companies and the first meeting was held September 22, 1995.

Participation on the task force was open to any member company wishing to be involved. Representatives from approximately 35 companies participated in one or more meetings⁷, and written comments were received from many more. The task force met numerous times over the subsequent months and distributed its first draft to the GISB membership in February 1996 for comments. The primary substantive changes in the GISB draft from the prior MidCon form

⁴. *MidCon Gas Services Proposes Master Natural Gas Sales/Purchase Contract for Industry*, FOSTER REPORT No. 2009, p. 27 (December 15, 1994).

⁵. Participants in the spring 1995 drafting effort were Akin Gump Hauer & Feld for NIPSCO, Aquila Energy Corp., Associated Gas Services, Inc., Columbia Gas Distribution Company, Conoco Inc., Entex Corp., Houston Lighting & Power Company, MidCon Gas Services Corp., Missouri Gas Energy/Southern Union, New York Mercantile Exchange, Sutherland, Asbil & Brennan for various end-users, Texaco Inc., The Williams Companies.

⁶. Karyl M. Lawson, *A Proposal for a Standard Natural Gas Sales/Purchase Contract*, NATURAL GAS CONTRACTS CONTRACT REPORT (The Thompson Publishing Group, May 1995).

⁷. The most active participants in the drafting process were Amoco, Aquila Energy Corp., Cabot Oil & Gas, Chevron U.S.A. Production Co., Columbia Gas Distribution, Consolidated Edison, Conoco Inc., Eastex Energy Inc. (El Paso), Equitable Resources, Enron Capital & Trade Resources, Entex, Exxon, Fina, Florida Power & Light, Houston Industries, MidCon Gas Services, NorAm Energy Resources, NYMEX, Tenneco Gas/Energy.

were reducing the number of service level options and narrowing the focus of the contract to short-term transactions. Comments received from GISB members were reviewed by the task force in March, and a final version was submitted to GISB's Executive Committee and to the full membership in April 1996. The standard contract was approved by vote of the GISB membership on May 13, 1996.

III. PURPOSE AND FORM OF THE STANDARD CONTRACT

A. Intended for Short Term (One Month or Less) Transactions

A primary guiding principle in drafting the GISB Standard Contract was universal appeal. Therefore, its provisions represent those perceived to be most typically used in today's marketplace. Since transactions involving multi-month commitments are more likely to involve unique features than shorter term commitment, the task force elected to narrow the scope of the standard contract to sales and purchase transactions which are either fully interruptible or have terms no longer than one month. The task force simply found too much diversity to achieve consensus on key contract provisions considered crucial by several companies in longer term commitments.

B. Standard Contract Format

The GISB Standard Contract consists of three documents.

1. The Base Contract is a single page which identifies the parties, their addresses and the contract date and references and incorporates the GISB standard General Terms and Conditions. The Base Contract also contains some boxes or blanks in which the parties must record their selection of certain options presented by the General Terms and Conditions. If these blanks are not completed, the contract will contain significant ambiguities. The Base Contract also bears the signatures of the parties.

2. The General Terms and Conditions ("GTC") is a six-page document setting out the general terms and conditions governing all of the transactions between the parties. The task force contemplated that the parties would not routinely exchange copies of the GTC in the formation of their contract, since it is accessible on the GISB home page on the internet at <http://www.neosoft.com/gisb/gisb.htm>. The downloading charge is \$25.00 for GISB members and \$50 for non-members.

3. The Transaction Confirmation is a single page negotiated and exchanged for each specific transaction to set out the price, quantity, delivery point, transporters, and other particulars for the transaction. There is no enforceable obligation under the Base Contract unless the parties have agreed to a specific transaction and evidenced the transaction with a Transaction Confirmation. As contemplated by the task force, the only appropriate place for documenting modifications or exceptions to the GTC is in the Base Contract or in the Transaction Confirmation.

IV. GENERAL TERMS AND CONDITIONS

A. Section 1. Purposes and Procedures

1. Transaction Confirmation Procedures Section 1 sets out the procedure for the parties to effect their agreement on a specific gas sale and purchase transaction through the use of the Transaction Confirmation. The parties must select one of two options for this procedure, *Oral* or *Written*, and indicate their selection on the face of the Base Contract. Both the Oral Transaction Procedure and the Written Transaction Procedure contemplate that the parties will reach

agreement concerning the details of their transaction by telephone and then one or both of the parties will send a written Transaction Confirmation documenting their agreement to the other party. The difference between the two procedures is the intended legal effect of the agreement between the time of the telephone conversation and the mutual execution of the Transaction Confirmation. The two options reflect the very real practices and related expectations existing in the spot market today.

2. Oral Transaction Procedure Under this procedure, the parties' verbal telephone agreement is intended to be binding pending exchange of the written Transaction Confirmation. This purported agreement by the parties that their oral conversation constitutes a writing poses obvious questions in the face of the applicable statute of frauds.⁸ However, since the actual practice of many marketers is to regard their telephone agreements as binding, the task force determined it appropriate to spell out those expectations clearly, even if actual enforceability in some cases may be questionable. Parties electing the *Oral* option may wish to tape record the conversations in which the agreements are struck, as some authority exists to support the sufficiency of a tape recording as a "writing"⁹ under the U.C.C. requirements.¹⁰ In light of some commentators' concerns about whether a tape recording made without the knowledge or consent of a party can be an "**intentional** reduction to tangible form", as required to constitute a "writing" under U.C.C. §1-201(46), parties intending to tape record their marketing conversations may wish to add a consent provision as a *Special Provision* to the Base Contract. (Such consent to tape recording language was omitted from the Standard Contract due to strong opposition by some industry participants.)

Of course, as a practical matter, the risk associated with the questionable enforceability of this provision is short-lived and curable, since even under the Oral Transaction Procedure, the Confirming Party must, and the other party may, send a written Transaction Confirmation to the other party which will become binding in the same manner as for the Written Transaction Procedure. Therefore, parties wishing to assure enforceability at the earliest possible time should make a practice of always sending a Transaction Confirmation to the other party as soon as practicable after making a telephone agreement and should provide for a short Confirm Deadline in the Base Contract.

3. Written Transaction Procedure Under this procedure, the parties are not bound by their telephone agreement until the written Transaction Confirmation becomes binding. A Transaction Confirmation may become binding in any one of three ways: (a) both parties sign a single Transaction Confirmation; (b) the parties exchange non-conflicting Transaction Confirmations; or (c) the party receiving the Transaction Confirmation fails to object to its terms in writing by the Confirm Deadline, which is the period of time elected by the parties in their Base Contract (two business days unless otherwise provided).

4. Electronic Data Interchange may be used by the parties to implement a transaction and the related Transaction Confirmation where the required technology is in place and the parties have entered into an appropriate agreement authorizing such transactions. Although electronic trading of physical gas volumes is currently limited to very specific markets where the

⁸. U.C.C. §2-201(1).

⁹. U.C.C. §1-201(46) defines a "writing" to include "any ... intentional reduction to tangible form."

¹⁰. *Ellis Canning Co. v. Bernstein*, 348 F. Supp. 1212 (D. Colo, 1972); 2 HAWKLAND, *UNIFORM COMMERCIAL CODE SERIES* §2-201:04 (1990).

transporter has established the required technology for certain participants, the general expectation is that it will be quite common in the near future. The development of the GISB standard contract was intended to facilitate the development of such electronic trading.

5. Options and Elections In order to fully implement this section, the parties must make three elections in the Base Contract. First, as stated above, they must choose the *Oral* or *Written* transaction procedure. Second, they must designate a Confirm Deadline, which is the length of time after a party's receipt of a Transaction Confirmation that the receiving party will be deemed to have accepted its terms, if he has not expressly refuted them. The default Confirm Deadline is two business days, based on the task force's observations of industry practice. The third election required of the parties is to designate which party will be obligated to send the Transaction Confirmation when they have reached agreement on a specific transaction.

B. Definitions

The definitions contained in the GTC are fairly standard. One commenter suggested referencing the quality standards within the definition of *Gas*, which is sometimes seen in these type of contracts, particularly those prepared by local distribution companies. However, defining *gas* so as to exclude any gas not meeting all of the quality specifications is inconsistent with the commercial and operational practices nearer the wellhead where a purchaser may from time to time be willing to accept limited amounts of off-spec gas. The task force elected instead to assure the seller's liability for damage resulting from the delivery of off-spec gas with the indemnity provisions in Sections 8.3 and 8.4.

C. Performance Obligations

The Standard Contract contemplates two levels of performance obligations: ***Firm*** or ***Interruptible***, which must be designated by the parties for each transaction by filling out the appropriate blank on the Transaction Confirmation. The parties may enter into both firm transactions and interruptible transactions under the same contract.

1. Interruptible Transaction Either party may interrupt deliveries or receipts at any time without liability to the other party, except that the interrupting party will be liable for any imbalance penalties resulting from the failure of the interrupting party to give timely notice of its interruption. If the parties wish a longer notice period for a particular transaction, then a provision to that effect should be included as a *Special Condition* on the Transaction Confirmation effecting that transaction.

2. Firm Transaction The seller and buyer must deliver and receive, respectively, on each day during the Delivery Period, the full Contract Quantity, which may be either a Fixed Quantity of MMBtu per day or a Variable Quantity. If it is a Variable Quantity, then either the seller or the buyer, but not both, has the right to nominate the Contract Quantity each day, between the minimum and maximum quantities stated on the Transaction Confirmation, and the other party is obligated to receive or deliver the nominated quantity on a firm basis. The only excuse for failure to deliver or receive gas under a Firm obligation is an event of force majeure. The definition of *force majeure* in Section 11 is fairly standard and excludes curtailment of non-firm transportation. If the parties wish to excuse performance for other reasons, eg., loss or curtailment of interruptible or secondary firm transportation unless primary, in-path, firm transportation is also curtailed, then a provision to that effect should be included as a *Special Condition* on the Transaction Confirmation effecting that transaction.

3. Damages for Breach of Performance Obligation

The GTC offers two options for specifying damages for breach of a Firm performance obligation: the ***Cover Standard*** and the ***Spot Price Standard***. The parties must elect which

standard will apply to their transactions and document their election by circling the appropriate designation on the Base Contract. The selected standard will then apply to all transactions implemented under that Base Contract. The parties must also choose a Spot Price Publication and designate it on the Base Contract. This selection is necessary for the Cover Standard as well as the Spot Price Standard, since it provides the measure of damages if the non-breaching party does not make an alternate sale or purchase of the gas that the breaching party failed to deliver or receive.

The Cover Standard essentially tracks the U.C.C. damage provisions.¹¹ If seller fails to deliver and buyer purchases replacement fuel, buyer's damages are the difference between the buyer's higher replacement costs and the lower Contract Price. If the buyer does not purchase replacement fuel, its damages are the difference between the higher Spot Price and the lower Contract Price. If buyer fails to receive Firm gas, and seller sells the gas elsewhere, then seller's damages are the difference between the higher Contract Price and seller's lower alternate sales price. If seller does not make an alternate sale of the gas, its damages are the difference between the higher Contract Price and the lower Spot Price.

The Spot Price Standard sets the measure of damages for seller's breach as the higher Spot Price minus the lower Contract Price and the measure of damages for buyer's breach as the higher Contract Price minus the lower Spot Price.

In both cases, damages calculated according to the specified standard are the exclusive and sole remedy available to the non-breaching party under the terms of the GTC. Consequential, punitive and special damages are expressly waived in Section 3.3. If the parties wish to establish additional penalties for breach of a Firm performance obligation for a particular transactions, a provision imposing a stated deficiency charge should be inserted as a *Special Condition* on the Transaction Confirmation effecting the transaction.

D. Transaction, Nominations and Imbalances

These provisions are fairly typical of their genre prevailing in the industry today. Section 4.1 simply establishes the respective responsibilities of the seller and buyer for transporting and delivering the gas. Section 4.2 requires the parties to coordinate their nominating activities with the affected Transporters to effect the deliveries contemplated under the contract. Earlier versions of Section 4.2 attempted to establish minimum time limits for the parties' nominating activities, but these minimum times were found to be inconsistent with actual nominating, scheduling and confirming practices in use among industry participants. Imbalance charges under Section 4.3 can either be in cash or in kind.

E. Quality and Measurement

The GT&C adopts the gas quality specifications and measurement practices of the receiving transporter as applicable to gas delivered under the contract.

F. Taxes

The Standard Contract offers two options for allocating tax liabilities between the parties, and the parties must indicate the selected option on the Base Contract. One option is for the buyer to have responsibility for taxes imposed at the delivery point; the other option is for the seller to bear any taxes imposed at the delivery point. In both options, seller bears taxes imposed upstream of the delivery point and buyer bears any taxes imposed downstream of the delivery point.

Several commenters suggested adding a provision to deal with the treatment of new taxes imposed after the date of a Transaction Confirmation, but the task force considered such a

¹¹. U.C.C. §2.703, §2.708, §2.711 and §2.712.

provision superfluous for the short term transactions contemplated by this Base Contract. Any parties contemplating use of the contract for longer term transactions should consider whether such a provision might be desirable.

G. Billing, Payment and Audit

These provisions are also rather typical of billing and payment provisions in use in the industry. Under Section 7.1 Seller is charged with preparing an invoice based on actual quantities delivered, if available, and scheduled quantities if actuals are not available. In order to implement Section 7.2, the parties must determine a Payment Date and choose a form of payment, eg., Wire Transfer, Automated Clearinghouse, or Check, and indicate their choices on the Base Contract. Buyer's payment in the prescribed form is due the later of ten days after receipt of the invoice or the Payment Date. Interest accrues on late payments at the prime rate listed in the *Wall Street Journal*, plus two percent per annum. Section 7.4 provides for audit rights and limits retroactive billing or payment adjustments to two years after the month of gas delivery unless written notice of the claim is provided during such two-year period.

H. Title, Warranty and Indemnity

1. Delivery Point

Unless otherwise specifically agreed, title to the gas passes from seller to buyer at the delivery point, meaning seller is liable and bears the risk of loss for the gas prior to the delivery point, and buyer assumes liability and risk of loss for the gas after delivery at the delivery point. In some cases (usually for local state tax purposes), the parties may wish to establish a point for transferring custody of the gas which is different than the point at which title is transferred. If such a modification is needed, an appropriate provision should be added to the Transaction Confirmation as a *Special Condition*.

2. Title Warranty

Seller warrants its right to transfer title and that it does transfer good and merchantable title to buyer free of all liens, encumbrances and claims. One commenter expressed concern about the lack of the seller's warranty that it actually has title, but the task force chose the "right to convey ... title" language in order to cover situations where the seller is acting in an agency capacity in selling gas under the contract. Seller's indemnity for title claims in Section 8.3 covers all gas delivered under the contract, whether owned by seller or by a third party for whom seller was acting as agent. If a third party asserts a claim against seller's title to the gas, buyer may demand assurance of seller's title under Section 10.1.

3. Indemnities

The indemnity provisions in Section 8.3 align with the division of liability set out in Section 8.1. Section 8.4, however, maintains seller's liability, as between seller and buyer, for any claims arising from off-spec gas, even after delivery to buyer. This provision is not intended to give buyer's customers a direct cause of action against seller, but rather to indemnify buyer for any such claims.

I. Notices

This provision contemplates communications by all forms likely to be available to the parties: mail, facsimile, courier service and electronic means. Section 9.3 establishes assumed receipt dates to operate in the absence of proof of actual receipt. The addresses of the parties are listed on the Base Contract.

J. Financial Responsibility

This provision permits a party to demand adequate assurances of performance from the other party when reasonable ground for insecurity exist, either as to payment or title to the gas. Under U.C.C. § 2-609, the party receiving such demand must respond within reasonable time, not to exceed 30 days, with reasonable assurances or be considered to have repudiated the contract. In addition, this provision permits a party to terminate the contract without prior notice upon learning that the other party becomes insolvent or files a bankruptcy proceeding or if a party defaults in a payment obligation. A seller is also permitted to suspend deliveries of gas if a payment is more than two days late.

Earlier drafts of the contract also contained close-out and netting clauses intended to permit a “netting” of all outstanding transactions in the event one of the parties became bankrupt. These provisions appear to have strong support in some areas of the industry but are regarded by a larger segment of the industry as inapplicable to the vast majority of their transactions. In view of the short and near term nature of the transactions contemplated under this base contract, the task force determined that such provisions were not appropriate for this standard contract. Parties considering the use of this contract for longer term transactions may wish to consider adding such close-out and netting clauses as *Special Provisions* to the Base Contract.

K. Miscellaneous Provisions

1. Assignability

Under Section 13.1, the contract is not assignable except among affiliates or by merger without the consent of the other party. This reflects the general practice in the industry.

2. Choice of Law

The parties are required under Section 13.5 to choose a state whose law will be applicable to matters arising under the contract. Several commenters suggested that the parties also bind themselves to a particular venue, but the prevailing view among the task force was that agreeing upon a venue would unnecessarily delay contract execution for the majority of industry participants for whom venue was not a compelling issue. Those parties who wish to specify the legal venue for lawsuits arising out of the contract should include a choice of venue provision as a *Special Provision* in the Base Contract.

3. No Confidentiality Provision

In light of the standard terms and conditions and very short terms of the transactions contemplated under this contract, confidentiality was not considered commercially significant. Parties wishing to use this Standard Contract form for longer term transaction may wish to add a confidentiality provision as a *Special Provision* to the Base Contract.

V. SAMPLE SPECIAL PROVISIONS FOR THE BASE CONTRACT

The Base Contract permits additions and modifications to the provisions contained in the GTC by the attachment of Special Conditions on separate sheets to be attached to the Base Contract. The addition of such sheets should be noted by inserting the number of attached sheets in the space provided at the bottom of the chart on the Base Contract form. Provisions added or modified for the Base Contract will affect all transactions effected under that Base Contract.

A. Consent to Tape Recording of Telephone Conversations

In order to assure that a tape recording of the parties’ conversation will be considered an intentional reduction of their agreement to tangible form, the parties should consent to such recording. Assuming that the parties elected the Oral Transaction Procedure, a provision expressing the parties’ consent to recording telephone conversations could be added to the Base Contract as a *Special Provision* as follows:

“The following sentence is added to the end of Section 2.1: The parties hereby consent to the tape recording of telephone conversations in which agreement to a Transaction is reached. Any such tape recording will be deemed a “writing” and “signed” by the parties for purposes of Section 2-201(1) of the Uniform Commercial Code and may be introduced as evidence to prove the fact or terms of a Transaction.”

B. Close-out and Netting Provision

As explained earlier, the task force did not include close-out and netting provisions in the Standard Contract because companies do not usually enter into one-month transactions far enough in advance to make use of such provisions. However, parties wishing to adapt the Standard Contract to one supporting longer term transactions may wish to consider adding such a provision along the following lines:

“A new Section 3.4 is added to the Base Contract as follows:

3.4 In the event that the non-defaulting party terminates the Contract under Section 10.1, hereto, the non-defaulting party shall have the right to designate an early termination date (“**Early Termination Date**”) as any date on or after the event of default under Section 10.1. Upon the Early Termination Date, the non-defaulting party shall have the right to liquidate any and all Transactions under this Contract (including any portion of a Transaction not yet fully delivered) then outstanding by:

(i) Closing out each Transaction being liquidated at its Market Value, as defined below, so that each such Transaction is cancelled and a settlement payment in an amount equal to the difference between such Market Value and the Contract Value, as defined below, of such Transaction shall be due to the Buyer under the Transaction if such Market Value exceeds the Contract Value and to the Seller if the opposite is the case; and

(ii) Discounting each amount then due under clause (i) above to present value in a commercially reasonable manner as at the time of liquidation (to take account of the period between the date of liquidation and the date on which such amount would have otherwise been due pursuant to the relevant Transaction); and

(iii) Setting off or aggregating, as appropriate, any or all settlement payments (discounted as appropriate) and (at the election of the non-defaulting party) any or all other amounts owing between the parties under this Contract so that all such amounts are aggregated and/or netted to a single liquidated amount payable by one party to the other. The net amount due any such liquidation shall be paid by the close of business on the Business Day following the Early Termination Date.

For purposes of this Section 3.4, “**Contract Value**” means the amount of Gas remaining to be delivered or purchased under a Transaction multiplied by the Contract Price, and “**Market Value**” means the amount of Gas remaining to be delivered or purchased under a Transaction multiplied by the market price determined by the non-defaulting party in a commercially reasonable manner. The rate of interest used in calculating net present value shall be determined by the non-defaulting party in a commercially reasonable manner. The parties agree that a Transaction under this Section 3.4 shall constitute a “forward contract” within the meaning of the United States Bankruptcy Code.

The non-defaulting party’s rights under this Section 3.4 and to the payments described in Section 3.2 accrued prior to the termination date are the sole and exclusive remedy of the non-defaulting party. The non-defaulting party shall give notice that a liquidation pursuant to this Section 3.4 has occurred to the defaulting party no later than the Business Day following such liquidation, provided that failure to give such notice shall not affect the validity or enforceability of the liquidation or give rise to any claim by the defaulting party against the non-defaulting party.”

C. Choice of Venue Provision

Parties wishing to designate the venue for any litigation arising under the Contract would add a provision as follows:

“The following sentence shall be added to Section 13.5: “The parties agree that the forum of any litigation arising out of this Contract will be in a state or federal court for _____ County (Parish), _____, and the parties hereby consent to the jurisdiction and venue of such courts.”

D. Confidentiality Provision

As explained earlier, the task force did not include a confidentiality provision in the Standard Contract because prices under one-month transactions are not generally commercially sensitive enough to outweigh the additional administrative burden of maintaining confidentiality in a true sense. However, parties wishing to adapt the Standard Contract to one supporting longer term transactions may wish to consider adding such a provision along the following lines:

“Confidentiality: The terms of any Transaction Confirmation hereunder, including but not limited to the Contract Price, the Contract Quantity, the Delivery Period, the identified Transporter(s), and all other material terms thereof shall be kept confidential by the parties hereto for one year from the expiration of such Transaction, except to the extent that any information must be disclosed to a third party for the purpose of effectuating transportation of Gas subject to the Contract or to meet New York Mercantile Exchange requirements or governmental orders or regulations.”

VI. SAMPLE SPECIAL CONDITIONS FOR THE TRANSACTION CONFIRMATION

Special Conditions affecting a specific Transaction should be noted in the box so labeled on the Transaction Confirmation. In light of the limited space, these provisions should be as brief as possible. Samples of the more common special conditions that parties might find useful are set out below:

A. Special Conditions affecting Performance Obligations

1. Extended notice period for interrupting Interruptible transactions

Section 2.17 does not require any minimum notice for interruption of an Interruptible transaction, except such notice as may be required to avoid the imposition of Imbalance Penalties. If the parties wish to provide for a longer notice period, usually 24 to 48 hours, for such interruption, the following provisions could be inserted as a Special Condition on the Transaction Confirmation, which the parties have marked as “Interruptible”.

“Any party failing to provide at least __ hours notice of curtailment will be liable for the damages provided in Section 3.2 for the period of such unprovided notice.”

or

“Any party failing to provide at least __ hours notice of curtailment will be liable for a penalty of __ cents per MMBtu times the daily Contract Quantity.”

2. Excusing performance due to loss of non-firm transportation

Under Section 2.15, interruption of Firm transactions may be excused only in the event of force majeure, which does not include the loss of non-firm transportation. Parties often wish to agree to performance commitments somewhere in between the Standard Contract’s definitions of Firm and Interruptible, sometimes called “Base” or “Baseload”, “Secondary Firm”, “Priority Interruptible”, or even “Firm” with a different definition of force majeure. One approach to forming this middle ground seen with increased frequency is to simply add the loss of non-firm transportation as an event of force majeure:

“Notwithstanding Section 11.3, loss or curtailment of any transportation, including interruptible or secondary firm transportation, will constitute an event of force majeure.”

3. Enhanced Deficiency Penalties

Several commentors suggested that simple cover damages as provided in Section 3.2 were insufficient to compensate a party for interruption of a firm commitment. Since this view represented a relatively small segment of the total comments received, the task force did not expand the penalty for nonperformance. However, such enhanced penalty provisions may be added fairly simply by the addition of the following Special Condition:

“In addition to any amounts due for the unexcused failure to deliver or receive gas under Section 3.2, the breaching party will pay the non-breaching party a Deficiency Penalty equal to ___ cents per MMBtu of Gas not delivered or received, as applicable.”

B. Addition of a Custody Transfer Point

In some transactions the parties may wish to have a title transfer point different from the point at which custody and responsibility for the gas is transferred. In such cases, a provision as follows may be included as a Special Condition.

“Notwithstanding Sections 8.1, title to the Gas will pass from Seller to Buyer at _____, although custody and all liability with regard to the Gas will pass from Seller to Buyer at the Delivery Point. Seller’s indemnity obligations under Section 8.3 will apply prior to delivery of the Gas at the Delivery Point, and Buyer’s indemnity obligations will apply after delivery of the Gas at the Delivery Point.”

VII. CONCLUSION

Considering the number of companies buying and selling gas each day and each month, it is reasonable to estimate that tens of thousand of spot transactions are concluded each month. Because of the extremely compressed negotiation time for these transactions, many (if not most) of these transactions are concluded with delinquent, inadequate, ambiguous or absent documentation. Further, the differences among the general terms and conditions in most contracts in use in today’s spot market are not substantive, but rather reflect different drafting styles and vocabularies. The differences in well drafted spot contracts¹² very rarely have distinct commercial value and therefore do not deserve extensive negotiation. The industry would therefore be well served to embrace a standard form for the spot market business. The GISB standard contract offers a very workable, balanced solution to the current waste of time and monies spent fitting antiquated contracting practices to a very new and different commercial reality.

¹². Well drafted spot contracts include those which include all essential provisions and are internally consistent. Poorly drafted spot contracts generally omit essential provisions and/or include internally inconsistent provisions or terminology.