Bloomberg Law

Drafting Guide

Cover Page to the NAESB Contract

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This Drafting Guide discusses the elections required in the Cover Page to the 2006 Base Contract for the Sale and Purchase of Natural Gas (the "NAESB Contract") and explains some of the typical changes made by counterparties. The standard form NAESB Contract has fifteen sections and while its terms are subject to negotiation between the parties, no modifications are made within the standard form. All elections are made in the Cover Page and amendments are made in the Special Provisions. For an overview of the NAESB Contract please see Overview: NAESB Contract for the Sale and Purchase of Natural Gas.

Election Title & Description	Drafting Issues & Analysis
Section 1.2 - Transaction Procedure	
The parties elect between the following two procedures to enter into a transaction: oral (default) or written. **If the parties elect Oral:** The Confirming Party sends a Transaction Confirmation within three Business Days (other party may also send a Confirmation). Failure to send a Transaction Confirmation does not invalidate Transaction. **If the parties elect Written:** The Confirming Party records the parties' agreement in a Transaction Confirmation and sends to other party by close of business on the Business Day following agreement. (Other party may also send Transaction Confirmation.) If both parties send Transaction Confirmations, the transaction will not be binding until either an exchange of non-conflicting Transaction Confirmations or deemed acceptance has occurred.	Whether parties choose Oral or Written depends on a number of factors, including a party's operational capabilities and its policies and procedures. However, typically parties prefer Written procedures if the transaction is not a short-term transaction (30 days or less).
Section 2.7 – Confirm Deadline	
The parties elect one of the following two Confirm Deadlines: two (2) Business Days after receipt (default) or [x] Business Days after receipt. The Confirm Deadline is the date by which the receiving party must object to the Transaction Confirmation or it is otherwise deemed accepted. The default is 5pm in the receiving party's time zone on the 2nd Business Day following day of receipt.	The Confirm Deadline can be extended or shortened depending on parties' preference, but parties typically agree to the NAESB default.

Election Title & Description	Drafting Issues & Analysis
Section 2.8 – Confirming Party	
The parties elect which party will send the Transaction Confirmation: Seller (default), Buyer or another party. The parties can elect that the party that is the Seller in a transaction or the party that is the Buyer in a transaction will always be the party sending the Transaction Confirmation. Or, the parties can agree that one of the parties will always be the Confirming Party, in which case the parties will add that entity's name in the Cover Page.	Since either party can be Buyer or Seller, parties very often name the party that will be providing the Transaction Confirmation.
Section 3.2 - Performance Obligation	
If a Seller fails to deliver a contracted quantity of gas or a Buyer fails to take a contracted quantity of gas, it is not an event of default under the NAESB Contract. There is a separate remedy for such failure and the parties can elect which remedy will apply: Cover Standard (default) or Spot Price Standard.	The Cover Standard is most typical as it provides for the mitigation of damages. Parties can also agree to damages, expressed in dollars or dollars per MMBtu, in a Transaction Confirmation executed in writing by both parties or in the Special Provisions. These are referred to as Alternative Damages.
Section 2.31 - Spot Price Publication	
The Parties elect what their spot price will be, which is used for either the Cover Standard or the Spot Price Standard: Gas Daily Midpoint (default) or another spot price, as agreed.	This election is driven by the transactions the parties enter into.
Section 6 - Taxes	
The Parties elect which party is responsible for taxes at the Delivery Point: Buyer Pays At and After Delivery Point (default) or Seller Pays Before and At Delivery Point. Gas production and sales may be subject to taxes, including state sales taxes or severance taxes, and therefore it is crucial that there be clarity as to which party pays taxes, if any, at the Delivery Point.	Parties rarely diverge from the default provision.
Section 7.2 – Payment Date	
The Parties elect the Payment Date: the 25th Day of the Month following Month of delivery (default) or the [x] Day of the Month following Month of delivery. Amounts due must be paid on the later of Payment Date or 10 days after receipt of the invoice.	Parties may want to amend the Payment Date to have the date on which payment must be made coincide with the payment date in other agreements, e.g. ISDA Master Agreements or EEI Power Purchase Agreements.

<table>
<tr><th>Election Title & Description</th><th>Drafting Issues & Analysis</th></tr>
<tr><td>Section 7.2 – Method of Payment</td><td></td></tr>
<tr><td>The Parties elect the Method of Payment: Wire Transfer (default), Automated Clearinghouse Credit (ACH) or Check.</td><td>Each party can select the Method of Payment it prefers to use. Checks are rarely used.</td></tr>
<tr><td>Section 7.7 – Netting</td><td></td></tr>
<tr><td>The Parties elect whether netting will apply or not: Netting applies (default) or Netting does not apply.

Unless otherwise elected, all payments due under the NAESB Contract are netted into a single amount. The party that owes the greater amount makes a single payment to the other party. Amounts due under a Credit Support Obligation or subject to the Liquidated Damages provision are not subject to the payment netting provision.</td><td>Whether or not netting is elected depends on the parties' operational capabilities. In general, parties are able and do agree to net across transactions so that on each payment date only one payment is made by one party to another.</td></tr>
<tr><td>Section 10.2 – Additional Events of Default</td><td></td></tr>
<tr><td>The parties may elect from among these additional provisions:

No Additional Events of Default (default)

Indebtedness Cross Default

Party A: ______________________
Party B: ______________________

Transactional Cross Default Specified Transactions:

____
____

In addition to the Event of Default in the NAESB Contract, the parties can elect to apply Additional Events of Default ("AEoD"):

Indebtedness Cross Default

Party or its Guarantor experiences a default under one or more agreements relating to indebtedness for the payment or repayment of borrowed money in an aggregate amount greater than the threshold. The default results in such indebtedness becoming due and payable. If the parties elect this AEoD, they add the threshold amount on the Cover Page.

Transactional Cross Default

A default under any other transaction or agreement between the parties for the purchase, sale or exchange of physical gas, and any other transaction or agreement identified in the Cover Page.</td><td>Many parties believe that the Events of Default in the NAESB Contract are sufficient; however some parties prefer to have AEoDs, to further protect their interests.

If the Indebtedness Cross Default is elected, the Indebtedness Cross Default is not triggered until the threshold is met or exceeded.

The threshold is an amount that is equal to or greater than the aggregate principal amount of Specified Indebtedness subject to a default, either alone or together with the amount that is in default.

Parties may sometimes agree to the following as a threshold:

• a fixed amount, e.g., $10,000,000
• a percentage of shareholder's equity
• a percentage of net asset value.

Threshold amounts are not necessarily symmetrical.

If the Transactional Cross Default is elected, the parties can add other agreements such as an ISDA, EEI or WSPP, that if subject to a default would cross default the NAESB Contract.</td></tr>
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Election Title & Description	Drafting Issues & Analysis
Section 10.3.1 – Early Termination Amount	
The Parties elect whether Early Termination Amounts apply. □ Early Termination Damages Apply (default) OR □ Early Termination Damages Do Not Apply If the parties agree that Early Termination Damages Apply, the Non-Defaulting Party determines: (i) Amount owed by each party for gas delivered or received either on or before the Early Termination Date. (ii) Other applicable charges related to deliveries and receipts. (iii) Market value of terminated transaction. If the parties agree that Early Termination Damages Do Not Apply, the Non-Defaulting Party determines: (i) Amount owed by each party for gas delivered or received either on or before the Early Termination Date. (ii) Other applicable charges related to deliveries and receipts.	"Early Termination Damages Apply" is the default and is typically agreed to by the parties. This election attempts to place the non-defaulting in a similar position as it would have been had its counterparty not defaulted.
Section 10.3.2 – Other Agreement Setoffs	
The parties elect whether Setoff will apply and if so, which type of setoff: Other Agreement Setoffs Apply (default) Bilateral (default) Triangular Other Agreement Setoffs Do Not Apply Once the non-defaulting party has determined the early termination amount under Section 10.3.1, parties determine whether set-off will only apply between the parties (bilateral), whether they will bring in their affiliates (triangular) or whether set-off will not apply at all.	If parties have more than one agreement in common, they typically apply setoff against the early termination amount calculated in Section 10.3.1. Market participants with affiliates that have agreements with their counterparty may want to expand the setoff right to include amounts owed under agreements with affiliates. However, re Lehman Bros. Inc., 458 B.R. 134 (Bankr. S.D.N.Y. 2011) has ascertained that cross-affiliate set-off is not enforceable in insolvency proceedings for lack of mutuality.

Election Title & Description	Drafting Issues & Analysis
Section 15.5 – Choice of Law	
The parties agree to the governing law of the NAESB Contract.	Choice of law to govern the NAESB Contract is agreed to between the parties and depends on their jurisdiction of incorporation or the parties may choose a neutral setting like New York. Note that there is no dispute resolution clause in the NAESB Contract and the parties should add a jurisdiction and venue clause.
Section 15.10 - Confidentiality The parties elect whether they will be subject to a confidentiality requirement.	Unless one or both parties are required by regulation, policy or otherwise to make their trading agreements available to the public, parties typically elect that the confidentiality provision will apply.
Special Provisions Number of sheets attached	
Parties may make additional changes to the General Terms & Conditions to reallocate risk, define damages for non-performance with greater specificity and clarify any ambiguity. These additional provisions are included in the Special Provisions.	
Section 3.4 - Termination Option	
The parties may agree to a "Termination Option" in the Special Provisions or a Transaction Confirmation. A Termination Option is an option that either party may have to terminate a transaction in the event that the other party fails to perform a Firm obligation to deliver gas in the case of Seller or to receive and make full and timely payment for gas in the case of Buyer for a designated number of days during a specified period.	A party may want to add a Termination Option to ensure that it receives gas from its counterparty and the counterparty is not relying on the Liquidated Damages provision to avoid performing under the NAESB Contract. If the parties choose to include a Termination Option, they add language to the effect that notwithstanding any other provision in the NAESB Contract, if a party fails to deliver or receive the contract quantity of gas to be delivered or received on a particular day for a period of [X] or more consecutive days and such failure is not excused (such failure, a "Performance Failure"), then upon [X] business day's prior written notice and for so long as the non-performing party fails to deliver or receive gas, the performing party may suspend its performance solely under such Transaction Confirmation for no longer than [X] days and shall not be obligated to resume its performance until the non-performing party provides at least [X] business day(s) prior written notice of its intention to perform such obligation.

Election Title & Description	Drafting Issues & Analysis
Section 10 - Capping of Adequate Assurance of Performance	
Parties may want to cap Adequate Assurance of Performance to the requesting party's exposure to its counterparty or to a percentage of exposure, e.g., 110% of exposure.	To ensure that a party is not subject to unbounded contingent liability, the parties may agree to cap the amount of “Adequate Assurance of Performance” that can be requested. If the parties choose to include a cap, they will add language to the effect that “Adequate Assurance of Performance” shall be **in an amount not to exceed the Contract Exposure of X as of the relevant date of determination.**” “Contract Exposure” means with respect to a party (“X”), the sum of (i) the net amount that would be payable to X if an Early Termination Date had been declared pursuant to the terms of the agreement (whether or not an Event of Default has occurred) and all transactions terminated and (ii) the net amount owed to X of all other payments owed but not yet paid between the parties, whether or not such amounts are then due, for performance already provided pursuant to any and all transactions conducted under this NAESB Contract; less (iii) any Adequate Assurance of Performance then held by X.”
Section 10 - Adding other Events of Default	
In addition to the Additional Events of Default, the parties may agree to add other events of default that are specific to the relationship between the parties.	The following events can be added as additional Events of Default: • Material breach of a representation or warranty, • Loss of any regulatory approval required for performance, • Potential or threatened litigation that would impair a party's, or if applicable, its Guarantor's, ability to perform under the agreement, • Judgment in excess of a certain threshold against a party, • Merger or similar transaction where remaining entity is materially weaker or where surviving entity does not assume the party's obligations, or • Change of control of ownership of a party or, if applicable, its Guarantor.

