

GAS CONTRACTS: THEN AND NOW

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INTRODUCTION

Contracts involving the sale, gathering, transportation, processing, storage, marketing, compression, and other services provided by the typical natural gas organization are crafted with contributions from several different functional groups and individuals. The expertise of these different groups and individuals is needed to put into writing an agreement that will allow an organization to invest capital in projects with known risk and expected rate of return and to carry on with the day-to-day business activities it was formed to do. This paper will discuss the various elements of typical natural gas contracts and the expertise called upon to draft these elements.

Few individuals involved in gas measurement or pipeline operations have law degrees. Few of the deal-makers involved in the commercial groups of pipeline organization have measurement or pipeline operating backgrounds, nor do the lawyers that may be employed by the organization or in private practice specializing in energy contracts. A contract contains elements that require the input from the various specialties in the pipeline organization and that are molded into a legal document by the lawyers.

THE LEGAL PERSPECTIVE

From a lawyer's point of view, natural gas contracts are not really different than any other contracts involving the sale of goods or services. Contracts for the purchase or sale of natural gas involves the passing of title and creates a buyer-seller relationship and the principles of the UCC (Uniform Commercial Code) apply. These contracts are different than those involving oil and gas leases, in which real property principles are applied. Other contracts for services, such as gathering, transportation, compression, storage, or processing do not involve the transfer of title. These agreements create a bailor-bailee relationship. All of these types of contracts contain the basic elements that are found in all contracts, which are offer, acceptance, and consideration.

The lawyer's job is to take the business requirements of the commercial group, the technical requirements of the engineering, measurement, and operations groups, and the operating requirements of the pipeline itself, and mold it into an document that can be agreed upon by the parties wishing to do business. Since the lawyer typically does not understand operating issues such as maintaining measurement standards, gas quality

standards, operating ranges and limitations of pipelines, and other operating issues, interpretation is necessary by technical and operations personnel. This allows the lawyer to make reasonable, legally defensible contracts that can be agreed upon, executed, and followed. It is not the lawyer's job to understand these technical issues. It is the lawyer's job to put these issues into legal language that will make it agreeable and enforceable.

The following are legal issues which are usually addressed in the contract:

- Term
- Warranty of Title
- Arbitration
- Force Majeure
- Default or Termination

THE TECHNICAL PERSPECTIVE

Many technical issues are involved when two companies agree contractually to either purchase or sell hydrocarbons or provide the various pipeline-related services. The primary issue that comes to mind is the quantification of the product being exchanged. This requires following accepted standards that ensure a mutually agreeable level of uncertainty. It also must clarify who will bear the expense of installation, operation and maintenance of the measurement equipment. The following are issues that are typically covered in the measurement clause of contracts:

- Quantity of Product
- Point of Delivery
- Product Quality
- Measurement Station Design
- Operating Parameters and Conditions
- Sharing of Data

Typical contracts usually specify the measurement equipment verification/calibration frequency and tolerances of measured versus actual values. They also specify that equipment verifications/calibrations must be scheduled in advanced and that non-operating parties be allowed to witness all of these activities, as well as supplied raw data for auditing. Many times, the non-operating party will require real-time operating data to be supplied on an important delivery, such as a power plant, so that constant monitoring can be performed.

COMMERCIAL PERSPECTIVE

The commercial group's responsibilities to a natural gas pipeline organization are to buy and sell quantities of natural gas and other hydrocarbons or to market services such as gathering, processing, storage, transportation, marketing, and compression. For the organization to be successful, the contracts entered into will assess the risk involved and provide an adequate margin that will provide a profit. Contract provisions, such as the term and price, are significant factors in whether a margin will be present. Dynamic market forces are always at work changing demand and supply, thereby affecting revenues. The contracts entered into need to make considerations for market forces when dynamic factors can change the economics during the term.

The contracts that the commercial groups initiate and execute for organizations drive most of the day-to-day work of the operations organization. Issues that are usually found in contracts that are driven by the commercial organization are:

- Quantity of Product
- Quality of Product
- Price
- Billing
- Obligations of Parties
- Charges
- Government Regulations

THE CONTRACT

The document itself usually contains several universal features that will be found in contracts throughout the industry. The cover page of the contract usually states the type of agreement that is contained within and the parties involved. A table of contents is usually found that lists all of the elements of the contracts and their page numbers. The actual statement of the contract that states the date of the agreement and the parties follows. Some of the other elements and some explanation follow.

General Definitions states the meanings of terms used in the contract. Technical jargon, such as units of measurement, is explained in detail. Many of these units can be stated using different pressure bases that vary from state to state, or company to company. Time periods for reporting quantities, such as contract day, month, and year, are explained as they also vary between companies. Receipt/delivery points are described, and may reference an exhibit found at the end of the document that uses drawings and maps to describe them.

Effective Date and Term states when the agreement will commence and the exact time and date it will terminate.

Obligations spell out the required actions of each party that are required by the agreement.

Services that will be provided in a contract for services.

Requirements specific to an agreement may be specified in this section. These could be operations parameters of a specific plant, notice and flexibility of scheduling volumes, nominations, etc.

Charges for each of the services provided will be specified.

Price for each unit of product when it is a purchase/sale type contract.

Contract Renegotiations may be included to specify the time frame when a replacement agreement or adjustment to the current agreement will be made.

Measurement clauses are used to state the details of the measurement equipment and practices to be used.

Non-Performance clauses specify conditions that cause one party or the other to not be in compliance with the agreement. Remedies for these non-performance issues may be specified.

Imbalance Provision may be included to provide a guideline to follow when an imbalance occurs during an accounting period, such as a contract month.

Gas Quality states the details on the specifications of the various contaminants, dilutents, components, and heating values that are part of the product stream.

Force Majeure states the definitions and details of events out of the control of the party claiming its occurrence.

Governing Laws and Regulations list the applicable regulatory bodies that have jurisdiction over the business being transacted.

This is not a complete list of all of the elements of the contracts being written for buying and selling natural gas, or for the provision of the various natural gas services. It does, however, list the elements that need to be read and understood by all who operate the pipeline and are responsible for the measurement, volume control, and accounting functions.

SUMMARY

Contracts for the buying and selling of natural gas, and for the provision of natural gas services such as gathering, processing, compression, transportation, storage, and marketing can be complicated and intimidating when looked at as a whole. However, when the individual parts are looked at individually and with the understanding of what each part is to accomplish, they are more easily understood. Remember, the lawyer's job is not to comprehend or understand all of the technical jargon used by measurement and operations

personnel. The lawyer's job is to understand what the commercial group wishes to accomplish with the contract and to put it into legally defensible language that states each party's intentions clearly.

The operations personnel must understand clearly what is required of them in adhering to contracts and in the witnessing of other party's execution of contracts. It may be helpful for measurement and operations personnel to sit down with the commercial group representatives that regularly work with contracts and get an interpretation of what is intended. Commercial personnel should always consult with the measurement group and the operations group when formulating contracts to ensure that the requirements can be met.

REFERENCES

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