Information & Instructions:: Gas contracts Nature

1. One of the most complicated contracts which a practitioner may deal with is a contract for the sale of natural gas, particularly if the gas is from a gas only well. This agreement is not simple because it involves long-term contracts with a product that cannot be easily stored and may vary as to the periods of need by the ultimate consumer.

2. A gas contract is further complicated by the regulatory complexities that exist under state and federal laws. Therefore, the parties must agree on what reserves are subject to the contract, the price to be paid for the gas purchased and sold, the buyer's purchase obligation, reservations by sellers, the condition and quality in which the gas shall be delivered to the buyer, and which party is to bear the cost of satisfying certain conditions.

3. Many of the above items are not subject to the agreement of the parties alone, due to the complex system of state and federal laws and regulations both through conservation measures, state public utilities agencies and the Federal Energy Regulatory Commission, (FERC), formerly known as the Federal Power Commission.

Information & Instructions:: Gas contracts

1. Independent from regulatory problems, the following areas should be covered in a gas contract:

   a. commitment of the lease, reserves and reservations;

   b. the price to be paid for the gas;

   c. the quantity of the gas which the producer is required to deliver;

   d. the quality of the gas delivered;

   e. pipeline arrangements; and

   f. conditions of delivery.

2. With respect to commitment and reservations, the contract must identify the leases subject to the contract, the substances covered, the depth of limitations, and the seller's reservations-including recycling rights, processing rights, and the right to use gas for operations.

3. Pricing provisions are affected by the long-range nature of the relationship, the differences in the quality of the gas, and the conditions under which the gas will be delivered. A typical contract will provide an initial base price, escalations which include both fixed periodic escalations and escalations based upon indefinite pricing provisions such as favored nation or renegotiated rights, reimbursement of certain producer costs, such as increase in tax and royalties, and adjustments based upon the quality of gas such as BTU content, delivery conditions and other conditions. All of these are subject to FERC review.

4. In the past, pipelines contracted for more gas than was required in order to ensure adequate supply. This occasionally lead to purchases by a pipeline which were inadequate to provide a reasonable return to the producer, and in some instances, threatened the producer with lease termination. To avoid the problem, many modern contracts now obligate the purchaser to purchase a specified quantity of gas, both annually and on a monthly basis.

5. This provision is usually on a take-or-pay basis. The purchaser must either take a specified volume of gas, or if the purchaser does not take said volume, pay for it anyway. Such an arrangement may require an agreement as to the reserves subject to the contract where the take obligation is not based on deliverability.

6. Take-or-pay provisions may seem relatively unimportant in a gas shortage market; however, it cannot be assumed that the purchaser will inevitably, over the life of the contract, not find itself in at least a temporary over-supply position.

7. A contract will also obligate the producer to deliver certain volumes of gas to the pipeline. Such obligations are normally dependent upon the wells to deliver the specified quantity. FERC has considered imposing obligatory drilling and reworking obligations on the producer if the producer is not delivering the specified quantities of gas to the pipeline.

8. One of the most critical parts of the contract is the conditions of delivery. A pipeline normally will be obligated to connect only to those wells which have sufficient reserves to justify the construction of the necessary pipeline facilities. Further, a pipeline may only be required to accept gas delivered at specified pressure which meets specific provisions concerning the quality including BTU content, liquid, solid, water vapor content, oxygen, carbon dioxide, sulfur content and temperature. This portion of the contract will provide for a point of delivery either at the well head or at a central point in the field.

Information & Instructions:: Natural gas -Industry segments

1. The natural gas industry is divided into three basic segments:

a. The producing industry which finds the gas, develops the fields, and delivers the gas at the well head, or at a central point in the field to the pipeline;

b. The transmission or pipeline industry which purchases the gas from the producer and transports it to the city gate or industrial site, which could be many miles away, across state boundary lines; and

c. The distribution industry which purchases the gas from the pipeline and distributes it to the individual, residential, commercial, or industrial customers within its franchised area.