

CONTRACTING IN THE ENERGY MARKETS: INDUSTRY “FORM” AND BESPOKE CONTRACTS AND THEIR STRUCTURE

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Discussion Topics

- Swaps/Derivatives
- Hedging
- Master Agreements
- Transacting under Master Agreement
- Scope of Master Agreements
- Confirmations
- Structure of Key Form Agreements
- Bespoke Transaction Documents
- Implied Terms/UCC



Overview of Derivatives

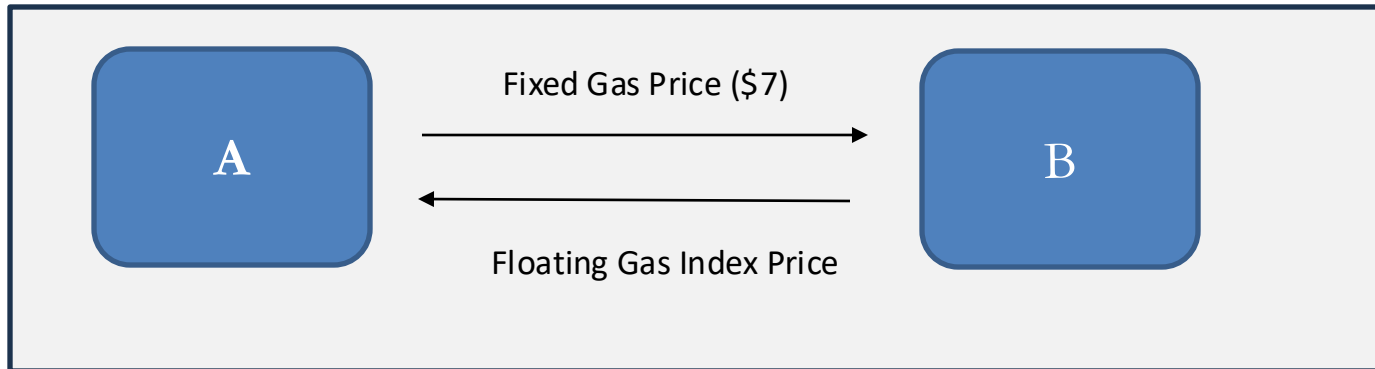
Basic Definition

- Financial transaction – no physical delivery involved
- The value of the transaction is derived from the price or value of some other source
 - E.g., an index price, a currency rate, a commodity price or an interest rate
- Commodity Swap Characteristics:
 - No physical delivery occurs
 - Each party agrees to pay a floating or a fixed price with respect to a notional quantity of a commodity
 - No Seller or Buyer designations – either party may be obligated to pay under the swap depending on whether fixed is greater than floating or floating is greater than fixed

- Commodity Fixed-for-Floating Swap:

Fixed Price Payer (“A”) pays fixed gas price of \$7/MMBtu

Floating Price Payer (“B”) pays floating gas index price per MMBtu



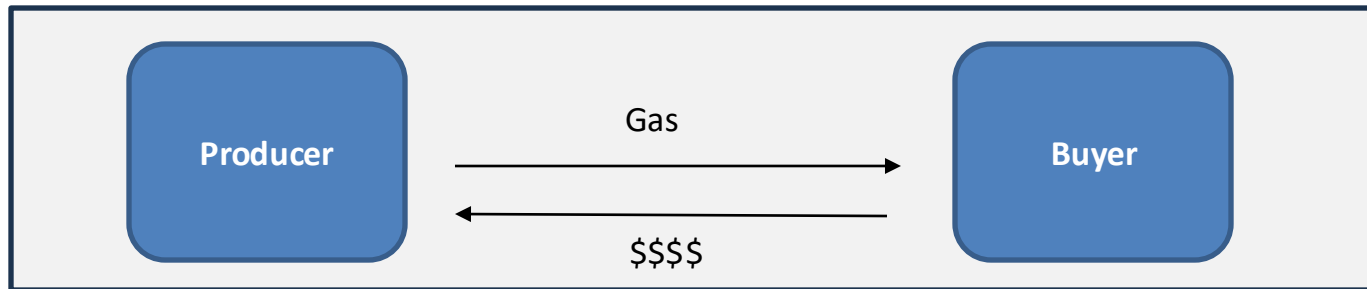
If Index Price is \$8: Party B pays Party A \$1.

If Index is \$5: Party A pays Party B \$2.

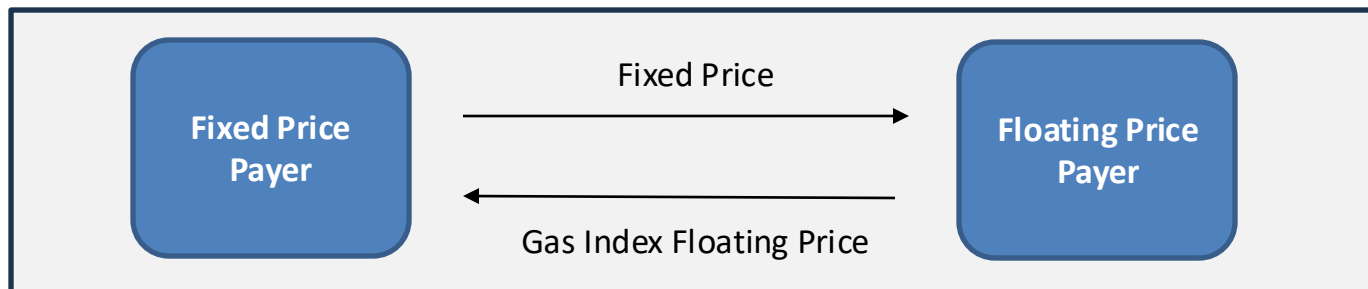
Note: Swap=derivative

Hedging

Physical Gas Deal



Gas Derivative



Hedge Mechanics

Assumptions: 10,000 MMBtu/day of physical gas, coupled with a fixed-for-floating swap at Henry Hub with a fixed price of \$3.50 and a notional quantity of 10,000 MMBtu/day.

Example 1 In-the-Money Hedge (Market ↑)	
Calculation	Result
Physical Gas Sale (10,000 × \$4.20)	\$42,000
Hedge Settlement ($[\$4.20 - \$3.50] \times 10,000$)	(\$7,000)
Net Revenue (\$42,000 – \$7,000)	\$35,000
Effective Price ($\$35,000 \div 10,000$)	\$3.50/MMBtu

Example 2 Out-of-the-Money Hedge (Market ↓)	
Calculation	Result
Physical Gas Sale (10,000 × \$2.80)	\$28,000
Hedge Settlement ($[\$3.50 - \$2.80] \times 10,000$)	\$7,000
Net Revenue (\$28,000 + \$7,000)	\$35,000
Effective Price ($\$35,000 \div 10,000$)	\$3.50/MMBtu

Master Agreements

- For many segments within the energy industry, participants have coalesced around specific Master Agreements or agreement types, depending on:
 - commodity involved
 - industry segment
 - Role in industry, and
 - to a lesser degree, geography
- Although called “form” agreements (“standardized” is probably a more accurate term), parties nonetheless engage in material negotiations with counterparties
- Starting from a common basic understanding of these master agreements with a counterparty, this standardization can:
 - reduce transaction costs,
 - increase efficiency, and
 - mitigate gap risks.

Misconceptions/Pitfalls

- Common misconceptions
 - Because these agreements are printed on forms, there can be little negotiation
 - Because they are commonly used in the industry, negotiations of such documents won't take long
- Choice of law provisions
 - Some agreements assume election of specific jurisdictions (e.g., New York law)
 - Electing a different jurisdiction can raise additional issues and risks, not apparent at the time of entering the contract
 - Before doing so, some legal and caselaw due diligence is warranted

Contract Forms Are Not Necessarily Neutral

- Master agreements reflect the context in which they were created (market conditions, the process used to develop the contract, the breadth of industry segment participation or insularity of the drafters, manner of development of the contract, the then prevailing risks, typical counterparties, etc.)
- Moreover, as time goes on, some of these forms may expand and seek to broaden their use
 - often beyond their original commercial setting
 - History, development, and counterparty expectations regarding such expanded products or such underlying transactions may be different from prior products
 - In some cases, these differences may cause sufficient risks enough to warrant significant changes/updates to the master agreement
 - By their nature, updates to standardized terms lag the developing problems and issues with the contract

Key takeaway: A “market standard” is a starting point, not a mandate.

Transacting Under Master Agreements

- The Reality of Execution
 - Internal Gatekeepers: Requires synchronized sign-off from Credit, Legal, and Back-Office functions.
 - The "Stop-and-Go" Effect can create delays and a loss of momentum:
 - Multiple document turns
 - Parallel negotiations (e.g., ISDA, NAESB, EEI)
 - Indeterminate Scope
 - Designed to govern unknown future transactions over an open-ended time horizon.
 - The breadth of topics required to cover long-term risks often extends the timeline beyond initial expectations.
- Negotiation Asymmetry
 - Risk Sensitivities. Counterparties prioritize or focus on different issues in negotiation (credit, netting, termination, sanctions, public perception).
 - Internal Institutional Constraints. Some positions are driven by internal policy or regulator expectations rather than deal-specific economics, limiting flexibility.
 - Need and Urgency. One party may need the agreement immediately, while the other has no near-term transactional pressure.

Master Agreements vs. Bespoke Contracts

Master Agreements

Developed through collective or institutional processes

Designed for repeat use across many transactions

Promote efficiency and standardization

Contain embedded assumptions based on typical use cases

Negotiation occurs within an established framework

Bespoke Contracts

Drafted directly between the parties

Designed for a specific transaction or relationship

Prioritize customization and deal-specific fit

Fewer inherited assumptions or constraints

Negotiation defines the framework itself

Key Distinction

Master Agreement: You work *around* the form.

Bespoke Contract: You *design* the deal.

Scope/Coverage Of Master Agreements

Typical Elements:

- Definitions
- Transaction Procedures
- Performance Obligations
- Transportation (e.g., rail, pipeline, barge, truck)
- Quality Standards
- Insurance
- Taxes
- Billing and Payment
- Title and Warranty
- Force Majeure
- Choice of law/Dispute Resolution
- Credit Support
- Representations
- Compliance with law/Sanctions

Confirmations

- With a Master Agreement in place, traders (or those wanting to enter into a deal (or “Transaction”) normally do not negotiate (or worry about) a majority of contractual terms associated with the deal because they already have been negotiated in an agreed-upon way for all Transactions (in the Master Agreement)
- Instead, they negotiate a much smaller set of terms – principally relating to price, duration, product, location, etc. These terms (which often are agreed-upon orally) are then sent out in a Confirmation.
- If the Party receiving the Confirmation does not timely object, then the deal will be considered binding.
- Confirmations generally cover applicable terms of a specific transaction or changes to the general terms
 - Transaction Date
 - Delivery Location
 - Delivery Date
 - Price
 - Product

ISDA Agreement Structure

- Single Agreement, Multiple Documents
- ISDA Master Agreement (1992 or 2002)
- ISDA Schedule: (choice of elections modifying the Master)
- Credit Support Annex
- Paragraph 13 to Credit Support Annex (choice of elections modifying the CSA)
- Commodity Annexes: Gas, Power, Coal, Crude, Emissions
- Confirmations – commercial terms
- Product definitions
- ISDA User's Guide

NAESB and EEI Structure

- NAESB
 - Base Contract for Sale and Purchase of Natural Gas (plus a Cover Sheet on which elections are reflected)
 - General Terms and Conditions
 - Special Provisions (where parties amend the terms of the agreement – with great specificity and care)
 - Confirmations
- EEI
 - EEI Master Power Purchase and Sale Agreement
 - Cover Sheet (for elections and modifications to PPA – again with great specificity)
 - Collateral Support Agreement
 - Schedules (addressing standards and/or representations depending on the type of entity or product)
 - Annexes (that are drafted for additional products, such as RECs)
 - Confirmation

- Various counterparties' each have their own version of a GTC, so the potential for an increasingly more complex system continues to increase – particularly in the crude and products markets.
- For those counterparties that don't draft their own GTCs, they may instead push one of the supermajor's forms as their preferred version.
- Others, including smaller and medium-sized energy companies invest the time and resources to develop their own GTCs

Bespoke Documentation

- Individually negotiated agreements drafted for a **specific transaction or commercial relationship**
- Typically used where:
 - The transaction is **complex, structured, or long-term**
 - Multiple products or services are integrated
 - Risk allocation does not fit comfortably within standard form agreements
- Often address **commercial, operational, and credit issues together** in a single framework

Bespoke Documentation (Cont.)

- May incorporate:, among other things
 - Physical supply obligations
 - Hedging or pricing mechanisms
 - Credit support or financing elements
 - Operational or asset-specific requirements
- Common examples include:
 - Tolling and offtake arrangements
 - Integrated wholesale supply frameworks
 - Multi-product or portfolio-based transactions

Key takeaway: Bespoke documentation allows parties to align contractual terms directly with the economics and risks of the transaction.

Implied Contractual Terms (UCC and Common Law)

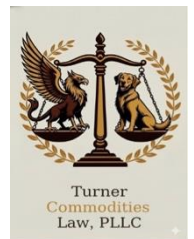
- In the absence of effective contractual disclaimers, default legal rules may apply
- Under UCC Article 2 (sale of goods), implied terms may include:
 - Formation without a signed contract between merchants
 - Implied warranties of merchantability and fitness for a particular purpose
 - “Battle of the forms” rules
 - Additional or different terms arising upon acceptance
- Applicability depends on the nature of the transaction:
 - **Goods:** natural gas, petroleum products, refined products
 - **Non-goods:** derivatives and swaps
 - **Gray areas:** power, RECs, bundled products, ancillary services

Key takeaway: Unaddressed implied terms can materially shift risk allocation.

Best Practices & Strategic Takeaways

- Standardized agreements are just tools: Use **market standards as a baseline** but recognize they often reflect the specific context and perceived risks of the authors at time they were created.
- Anticipate the future: Standardized contracts updates notoriously address prior problems; in bespoke terms or bespoke agreements, account for and **address major emerging risks** and the modern energy evolution.
- Build a **realistic timeline**: Account realistically for your actual approval process when setting commercial deadlines to avoid "stop-and-go" delays.
- **Consider the deal** and the parties: Use bespoke documentation when commercial leverage or unique asset risks require flexibility that standard forms lack.
- Market **standard contracts** are a starting point, **not a destination**: Never view a "printed form" as a mandate; prioritize the specific commercial intent of the transaction.

Questions?



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