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Winter Storm Uri

Were marketing agreements properly insulated to withstand the deep freeze?

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I. INTRODUCTION

In February 2021, Texas experienced Winter Storm Uri—an unusually severe winter storm that significantly impacted nearly every sector of the energy industry from oil and gas production to electricity generation. The unique challenges presented by Winter Storm Uri stress-tested standard industry agreements and practices related to the transportation and sale of natural gas. While, in general, these standard agreements performed as expected, the severe impact of Winter Storm Uri may incentivize sellers and purchasers to better account for extreme weather conditions and price fluctuations in the future. Among other items, parties may consider including special provisions within their gas purchase contracts to address the following:

- Risks associated with gas purchase agreements that place a disproportionate emphasis on first of the month pricing;
- Force majeure provisions that do not clearly articulate whether and how a seller may allocate gas to avoid liability when a force majeure event prevents compliance with some, but not all, firm commitments;
- A ranking system or dedicated acreage commitment to establish firm commitment priorities during a force majeure event that limits supply;
- Force majeure provisions that do not clearly articulate whether a purchaser may demand that a seller change delivery to a reasonable alternate delivery point if the primary delivery point becomes unavailable;
- Limit on cover damages caused in whole or in part by a force majeure event; and
- Provisions addressing whether the purchaser may net any cover damages incurred.

Proactively addressing the points of contention raised in the aftermath of Winter Storm Uri will allow the parties to become more certain of their duties and obligations in their gas purchase contracts during future extreme weather events.

II. NAESB BASE CONTRACT AND TRANSACTION CONFIRMATIONS

The North American Energy Standards Board ("NAESB") publishes the form *Base Contract for Sale and Purchase of Natural Gas* (the "Base Contract"). The Base Contract provides a widely-used framework from which parties may agree to the purchase and sale of natural gas through transaction confirmations. Among other items, the Base Contract is the mechanism by which the parties agree to governing law, limitations on damages, force majeure provisions, and notification and payment procedures. The current iteration of the Base Contract was last revised in 2020, and previous versions were published in 2006, 2002, and 2000.[1]

[1] Unless otherwise noted, references to the Base Contract refer to the 2020 version.

Upon execution of the Base Contract, the parties may then agree to transaction confirmations, each of which govern significant aspects of a specific sale, including: the amount of natural gas subject to the transaction; whether sales and purchases are firm or interruptible; the sales price; and the delivery point. The Base Contract generally specifies whether the transaction confirmations are oral or written. Therefore, the Base Contract and all of the specific transaction confirmations comprise the entire agreement between the parties.

III. TRANSACTION CONFIRMATIONS—PURCHASE PRICE

The price for the purchase and sale of natural gas is governed by the transaction confirmations. *See* NAESB Standard 6.3.1, Section 3.1. The parties, through the transaction confirmations, may choose from several readily accessible pricing mechanisms, including posted prices at various sales "hubs" (such as Henry Hub, Katy, and Waha) or prices posted in widely accepted trade publications (such as *Inside FERC*).

Sellers and purchasers may seek early certainty concerning monthly revenue and expenses by agreeing to place a disproportionate importance on "first of the month pricing." For example, the parties to the transaction confirmation may agree to a hybrid model by which 80% of the natural gas sold receives the index price posted on the first day of the month and 20% of the natural gas sold receives the index price posted on the day the seller delivers the gas.

First of the month index pricing may (during times of price fluctuations caused by extreme weather events) expose the seller to the downside of exponentially higher delivery costs without a proportionate corresponding benefit of higher sales prices, particularly where the transaction confirmation places the burden of costs and expenses incurred prior to the delivery point on the seller. Significantly, first of the month index pricing may expose the seller to the entire risk of volatility in the electricity market.

For example, during Winter Storm Uri, the price of electricity in Texas rose to $9,000 per MWh on February 15, 2021. In his presentation to the Texas Independent Producers and Royalty Owners in September 2021, John Harpole of Mercator Energy, LLC (an energy consulting firm based in Colorado) estimated that $9,000 per MWh resulted in a transmission cost of approximately $48.60 per Mcf, as compared to the typical electricity cost of $.14 per Mcf.[2]

However, sellers agreeing to first of the month index pricing did not receive a fully proportionate price increase to offset the rise in transmission costs. The February 2021 first of the

[2] Mr. Harpole's presentation is available on the Mercator website: http://www.mercatorenergy.com/presentations/. Mr. Harpole estimated electricity costs of $50.40 per MMBtu, which was converted to Mcf by dividing by 1.037. *See What are Ccf, Mcf, Btu and therms?* U.S. Energy Information Administration https://www.eia.gov/tools/faqs/faq.php?id=45&t=8#:~:text=One%20thousand%20cubic%20feet%20(Mcf,1.037%20MMBtu%2C%20or%2010.37%20therms (last accessed Mar. 17, 2022).

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