Anatomy of a Contract

Inside Standard Terms and Conditions

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These materials, including the examples set forth herein, do not constitute legal advice and are for illustrative purposes only. Each contract will likely have unique legal and factual circumstances that should be reviewed by counsel familiar with the law application to the transaction.
This fast-paced session will highlight some of the material terms that frequently appear in sales contracts and how to deal with them from a practical perspective. Discussion will focus on what to review specifically within the contract, such as passage of risk/title, termination rights, billing and payment terms, and default and remedy provisions. This session is geared for the new and intermediate credit analysts and will also be a great refresher for the more seasoned participants.
What is a Contract?

- Offer
- Acceptance
- Consideration
- A promise or a set of promises that give rise to—
  - a duty to perform, and
  - a legal remedy for failure to perform
Contracts Define

- Who
- What
- Where
- When
- Why
  - In a capitalist society the object is to make a buck
- How
Two Sets of Rules Govern a Contract

- Common law (principles and rules derived from historical usages, customs and court rulings).
- Statutes enacted by legislative bodies.
The Uniform Commercial Code

- Drafted as a model act to harmonize the laws of commercial transactions across the county.
- Article 2 on Sales adopted in some form by every State except Louisiana.
Between merchants, additional terms in an acceptance become part of the contract so long as —

- the offer is not limited to its terms.
- the offeror does not object to the new terms within a reasonable time; and
- the new terms do not materially change the contract.
- If new terms in the acceptance materially change the contract, the conflicting terms cancel each other out.
Integration Clause

Example:

- **Entire Agreement:** This contract constitutes the entire agreement between the parties relating to the sale of the products and supersedes all previous communications, representations, or agreements, either oral or written, with respect to the subject matter hereof. No prior representations or statements relating to the sale of the products made by any representative of Seller that are not stated herein shall be binding on Seller. No addition to or modification of any provision of this contract shall be binding upon Seller unless made in writing and signed by a duly authorized representative of Seller.

- NAESB, WSPP, ISDA, and EEI form contracts each contain different integration clauses
Example:

- This contract may not be amended, revoked or modified in whole or in part except by a writing executed by both of the Parties.
- NAESB and EEI form contracts contain prohibitions on oral amendments and modifications.
- WSPP form contract has a detailed quasi-legislative process for amending the form contract.
This contract may be signed in counterparts, each of which shall be deemed to be an original as against any party whose signature appears thereon, and such executed counterparts may be transmitted by facsimile or email, with the same legal effect as if the original signatures thereto were upon the same instrument. This contract shall become effective when one or more counterparts hereof, individually or taken together, shall bear the signatures of all of the parties reflected hereon as the signatories.

- WSPP and ISDA form contracts include a similar “counterparts” provision.
Contract Interpretation Rules

- “Integrated Contract” - the complete and exclusive statement of the contract terms.
- The Parol Evidence Rule: the terms of an integrated contract may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement.
General Terms and Conditions

- Generally one-sided
- Define how to perform
- Defines a default
When a contract omits terms, the UCC may “fill the gap” by looking to:
- Custom
- Statutory law

The UCC fills the gaps on open terms such as:
- Price
- Quantity
- Time
- Payment
  - by reading in a “reasonable” price or time, etc.
Example:

- **Payment.** Payment shall be due net thirty (30) days from the date of invoice. Buyer agrees to pay interest on any unpaid balance at a rate of five percentage points above the annual Federal Funds rate as specified in the Wall Street Journal on the day the balance becomes due. Unless otherwise agreed in writing, all payments are to be in United States dollars. For contracts for delivery outside the United States, Seller may require payment to be secured by an irrevocable letter of credit or a bank guarantee acceptable to Seller. Where payment is made by letter of credit, all costs of collection shall be for Buyer’s account.
Credit Terms

Example:

- **Credit.** If Seller extends credit to Buyer, payment terms shall be net thirty (30) days after Seller's invoice. Seller may change or withdraw credit amounts or payment terms at any time for any reason.
Example:
This Agreement shall expire on June 5, 2019; provided, that if as of such date the Debtor has fully performed all of its obligations under this Agreement without default, the Agreement shall automatically renew for an additional one year term.
Example:

Default. Any of the following events or conditions constitute an Event of Default under this Agreement: (a) the failure of Customer to make any payment when due of any indebtedness of Customer to Seller arising independently of this Agreement; (b) if Customer fails to make any payment under this Agreement within ten (10) days after the due date, without notice or demand of Seller; (c) the failure of Customer to fully comply with and perform any and all terms and conditions of this Agreement and its Attachments, which failure remains uncured for a period of thirty (30) days after written notice thereof; (d) the making of assignment for the benefit of creditors by Customer; (e) the institution of bankruptcy, reorganization, liquidation, or receivership proceedings by or against Customer or Seller; and (f) insolvency of Customer or Seller or impairment of the credit of Customer.

- Default provisions in the EEI, WSPP, and NAESB form contracts are substantially similar to this example.
- ISDA form contract has very detailed default provisions.
Remedy Provisions

Example:

- Upon the occurrence of any of the Events of Default, Seller in its sole discretion shall have the right to exercise any one or more of the following remedies: (a) to terminate this Agreement; (b) to declare the then remaining unpaid balance of the initial purchase and all other agreed charges, taxes and assessments due and payable under this Agreement; (c) with or without notice, demand or legal process, to retake possession of the Products (and Customer authorizes and empowers Seller to enter upon the premises wherever the Products may be found) and (i) retain such Products and all payments made under this Agreement, and (ii) to pursue any other remedy provided by law. Customer also agrees to pay all costs of collection, including without limitation, court costs, reasonable attorneys’ fees, fees for repossession, repair, storage and sale of the products.

- EEI, WSPP, ISDA, and NAESB form contracts default to liquidated (predetermined) damages, instead of more traditional remedies.
Waivers of Punitive Damages and Consequential Damages

Version 1: Neither Party shall be entitled to, and each of [Seller] and [Buyer] hereby waives any and all rights to recover, consequential, incidental and punitive or exemplary damages, however arising, whether in contract, in tort, or otherwise, under or with respect to any action relating to or arising out of this Agreement. The foregoing provision shall not apply to (a) incidental, special, punitive, indirect or exemplary damages attributable to third party claims, or (b) any such damages attributable to gross negligence or willful misconduct.

WSPP, NAESB, and EEI form contracts contain waivers of punitive and consequential damages because liquidated damages are provided.
Example:

- **Passage of Title.** Title to the products passes to the Buyer when they have been delivered to the Buyer or received into its care and control.
Transfer of Title in Energy Contracts

- Transfer of title is a very important term in energy contracts.
- Title generally transfers at “delivery point” (NAESB & EEI).
- Depending on the type of energy involved, the nature of “title” and delivery point varies.
  - For transfer of coal, which can be verified and tracked by composition and source, title can be connected to a distinct tangible object and transfer to a specific location (i.e., onto a barge).
  - For gas and power, which generally cannot be verified directly by source and segmented into units, transfer will be based on instrument readings and title will be transferred in relation to equivalent quantities and not in relation to any tangible portion.
Example:

- **Risk of Loss.** Seller shall be responsible for risk of loss prior to the delivery point and buyer shall be responsible for risk of loss after the delivery point.
  - EEI and NAESB form contracts apportion risk of loss in this manner.

- Risk of Loss in Sales Contract
  - Example: **Risk & Insurance.** Responsibility for loss of or damage to any product sold under this contract passes to Buyer when those products are delivered or transferred to Buyer’s carrier.
Forum Selection Clauses

- Jurisdiction
- Venue
- Arbitration
  - Common terms in most contracts.
  - Generally, default jurisdiction/venue clauses are absent in the major standard physical energy contracts, however, the ISDA form contract includes a limited jurisdiction/forum selection clause.
Example:

- Buyer agrees that non-exclusive jurisdiction for any dispute arising out of or relating to this contract lies within courts located in the State of Texas and consents to venue in Dallas County, Texas. Notwithstanding the foregoing, any judgment may be enforced in any United States or foreign court, and Seller may seek injunctive relief in any United States or foreign court.
Example:

- **Consent to Jurisdiction and Service of Process.** Buyer irrevocably appoints each and every officer of Buyer as its attorneys upon whom may be served, by regular or certified mail at the address set forth in this Agreement, any notice, process or pleading in any action or proceeding against it arising out of or in connection with this Agreement. Buyer hereby consents that any action or proceeding against it may be commenced and maintained in any court within the State of Illinois or in the United States District Court for any District of Illinois by service of process on any such officer. Debtor further agrees that such courts of the State of Illinois and the United States District Court for any District of Illinois shall have personal jurisdiction of Buyer.
Example:

Unless otherwise agreed in writing, this contract shall be governed by and construed under the laws of the State of Maine, without regard to its choice of law rules.

- WSPP form contract: Law of Utah applies in all WSPP contracts; no choice of law clauses permitted.
- NAESB form contract: Choice of law clause permitted, but if the parties do not select a certain jurisdiction’s laws there is no default choice of law provision.
- ISDA Power Annex: Choice of law permitted, usually NY.